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The Province of Alberta

IN THE MATTER OF "THE NATURAL
GAS UTILITIES ACT"

—and—

IN THE MATTER OF an Enquiry into
Scheme to be adopted for Gathering,
Processing and Transmission of
Natural Gas in Turner Valley

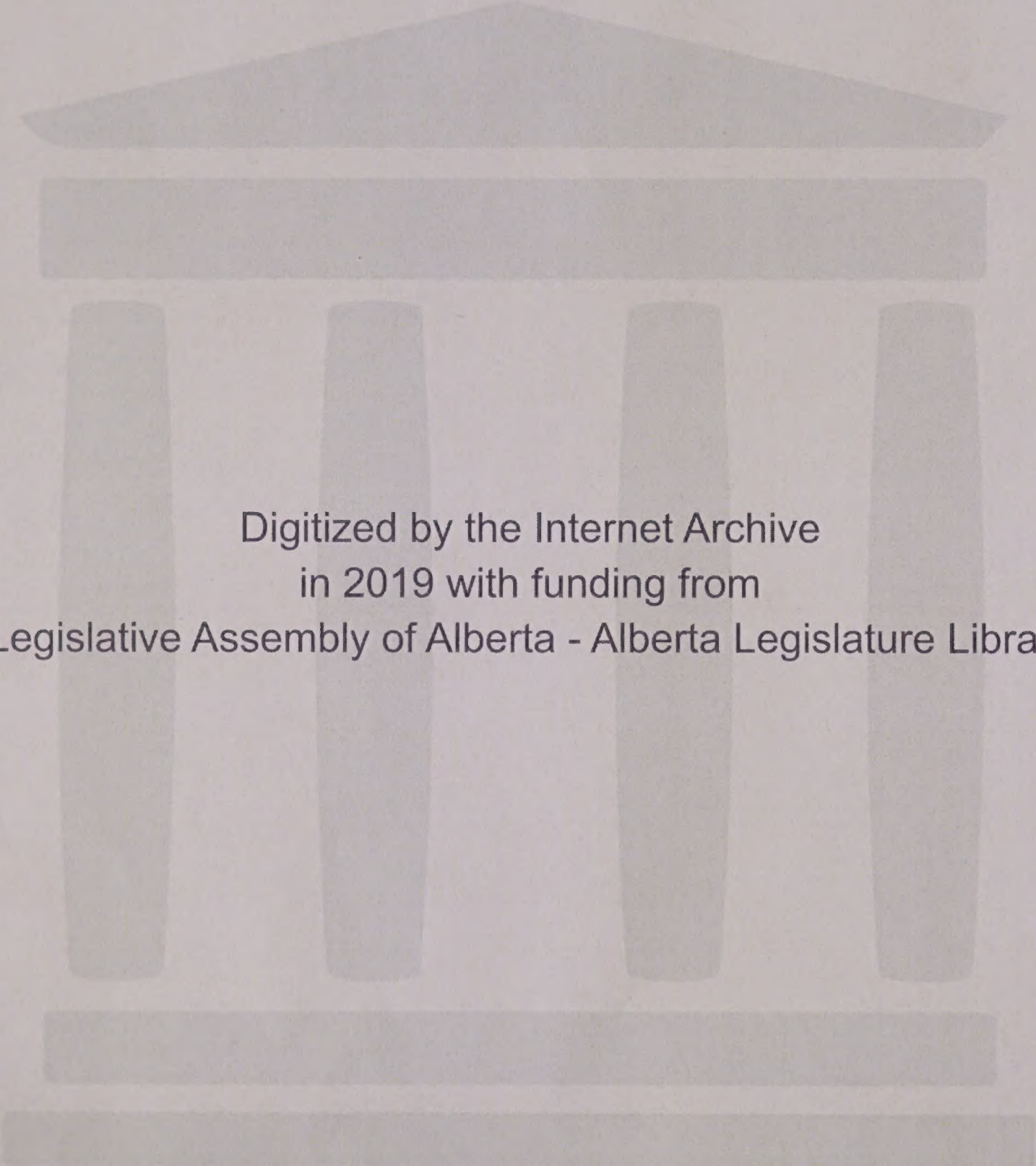
G. M. BLACKSTOCK, Esq., K.C., *Chairman*

Dr. E. H. BOOMER, F.C.I.C., *Commissioner*

Session:

CALGARY, Alberta December 10th, 1945

VOLUME 58



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I N D E X

VOLUME 58

December 10th, 1945.

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H-1-1 9.30 a.m.

R.W.Hamilton,
Cross-Exam. by Mr.Fenerty.

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9.30 A.M.Session
December 10th, 1945.

THE CHAIRMAN: Well, who is it this morning?

MR. FENERTY: I guess I had not finished
cross-examination on the first part.

THE CHAIRMAN: All right.

ROBERT WINSLOW HAMILTON, recalled,
already sworn, cross-examined by Mr. Fenerty, testified as
follows:-

Q Mr. Hamilton, when your examination was adjourned we were
discussing charges which might properly be made against
capital as compared to charging the same things against income.
With reference to that point of a million dollars worth of charges,
or the charges which you estimated would work out on the basis
of a quarter of a million dollars, that is what we were dis-
cussing. And in connection with those do you agree with the
proposition that the nature of the charges will determine their
proper allocation?

MR. BLANCHARD: Excuse me, Mr. Fenerty. I wonder
if you will give more clearly just what you were discussing?

MR. FENERTY: Just to go back, I am referring
now, Mr. Blanchard, to a discussion that took place during Mr.
Hamilton's cross-examination some time ago. It is found in
Volume 50, at the end of Volume 50. You will see what the
discussion was there.

THE CHAIRMAN: What page?

MR. BLANCHARD: 3938, Sir.

MR. HARVIE: I wonder if you would read it,
Mr. Fenerty, so that we can all get it.

MR. CHAMBERS: What page?

MR. MORRISON: 3938.

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MR. FENERTY:

I am afraid we will have to go

through a few pages.

Q Just let us discuss it, Mr. Hamilton, and we will bring it back into the minds of the Counsel. You will remember, Mr. Hamilton, that I did have some discussion with you about the proper allocation of charges, which you said in your report you felt might properly be charged to capital, although the Royalite Company had apparently charged them against income, which would amount to something in the neighbourhood of a quarter of a million dollars?

A That is right. Added to the rate base, not to capital.

Q Added to the rate base, not to capital?

A Yes.

Q And charges which you felt had the Royalite Company been under regulation previously, might not have been treated in the way you had treated them?

A That is correct.

Q Now, does that bring Counsel back to it?

MR. BLANCHARD:

I am still uncertain as to what those particular charges consisted of.

MR. FENERTY:

It is set out in Volume 2, in the schedule there.

Q MR. BLANCHARD: Are those the items of overhead?

A Yes sir.

Q MR. FENERTY:

Mr. Hamilton, I want to ask you just a couple of general words on that. Do you agree with the proposition that the nature of the charges themselves determines their proper allocation, whether they should be charged against capital or income?

A The nature of the charges and the purpose for which the determination is made, Sir, would both be factors which enter into

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it.

Q I want you to explain the latter part of the statement, Mr. Hamilton, the purposes for which they are made. Is it felt that the nature of the charges have something to do with it?

A That is correct.

Q And then will you explain how the purpose for which they are made can affect the situation?

A Well, this is a very good instance on the point, for purposes of determining taxable income that might be quite proper to charge a particular expenditure to current operations to determine taxable income.

Q You mean, if you are seeking to reduce your taxable income, it is proper to charge them in that way?

A It might be, yes.

Q Yes?

A And then again it might be proper in order to determine the income on the most conservative basis so that not to unduly mislead shareholders, you might treat an item and put it to current operations, then in order to determine the rate base you might charge it in a similar or a different manner.

Q Then your idea of accounting practice that really is the dominant feature, is the purpose that you seek to accomplish, is that it?

A That is one of the features, not the most important perhaps.

Q Let us get this. Do you first determine the nature of the charges? You have got to find out what they are all about?

A That is right.

Q Now, why are you concerned what they are all about. Do you charge them one way or the other, depending upon what purpose you might want to accomplish?

A You want to know what the charges are in respect to, and know in what manner they should be dealt with.

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Q You first determine the nature of the charges and do you give any consideration, first, as to where those would, - I was going to say normally go, - but there is not any normal allocation?

A Yes, that is right, there is no normal allocation.

Q First you find out what the nature of the charges are?

A That is correct.

Q And then you set out what is the most advantageous method from the point of view of the Company you are dealing with?

A Not necessarily charges. The most important consideration is to give a reflection for the purpose of published statements for the benefit of shareholders and general public.

Q I see?

A That is usually the most important consideration.

Q And having made an allocation with that purpose in mind you think it would be quite proper for us to make an entirely different allocation when you had some other purpose in mind?

A Quite so.

Q And sustain both of them?

A Quite so.

Q I see.

A And do so frequently.

Q I see.

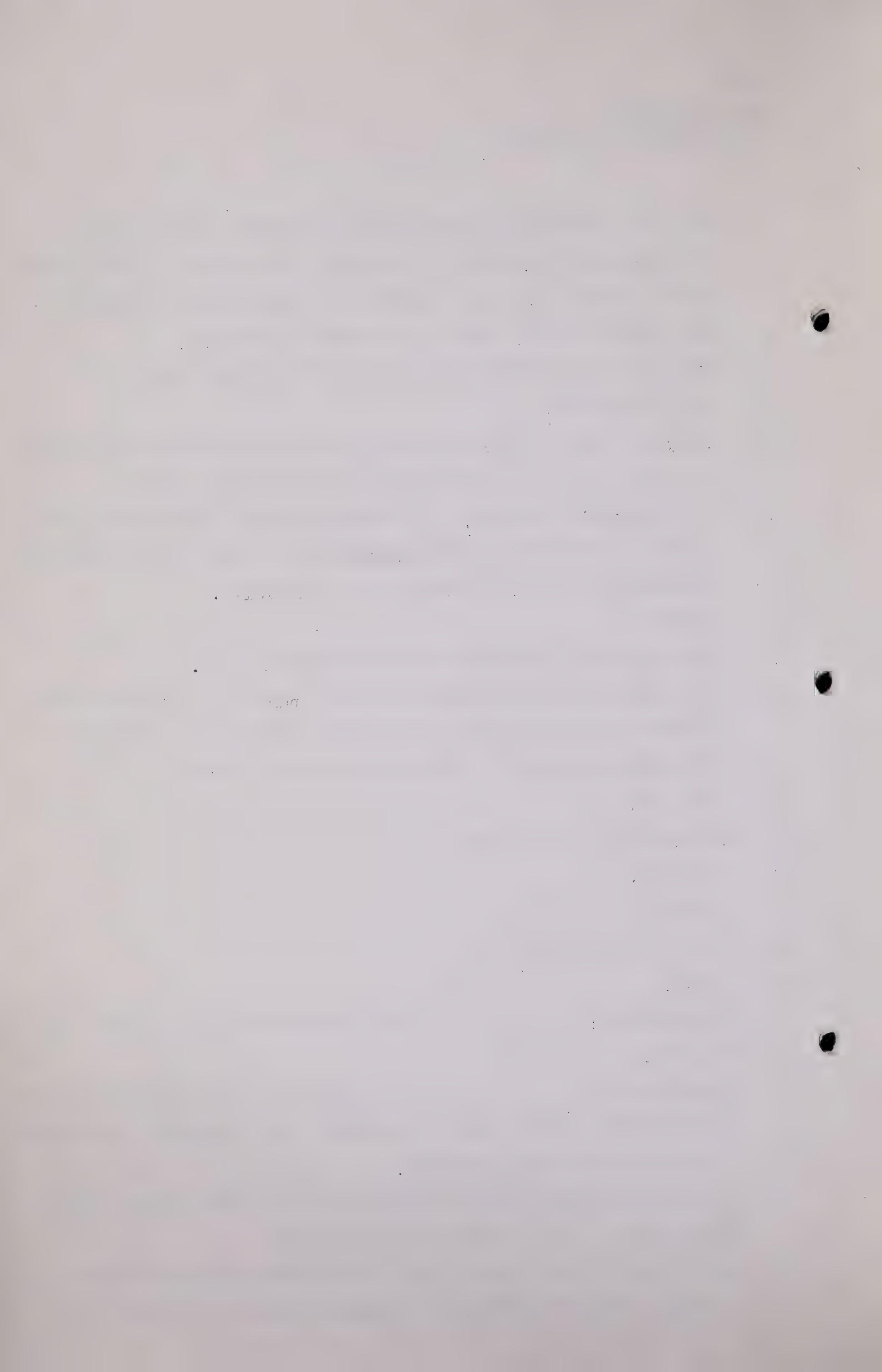
Q THE CHAIRMAN: It depends on who you are talking to?

A Yes sir.

Q MR. FENERTY: I do not think the fact that you do so frequently enters into the picture, that is one of the things I am seeking to find out about.

A I did not want you to get the idea that this was a novel concept, Mr. Fenerty. It is common to our practice.

Q Yes, I see. And I take it you see nothing inconsistent or unusual in the allocation of charges to income for income tax



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purposes and the subsequent allocation of those charges to capital so that they will add to the rate base for utility purposes?

A I think it must be borne in mind that there is a distinction to be drawn between a case where the original allocation was made under regulation and a case where the original allocation was not made under regulation.

Q And that brings us to this question, that we discussed with Professor Stewart. You heard that discussion. I do not want to take too much time. We have been going a long time already. But you heard the suggestion I made to Professor Stewart that inasmuch as $7\frac{3}{4}$ cents rate paid by the Gas Company to the Royalite Company was tied down by contract at a time when that rate was subject to review by the Board of its own initiative or on the complaint of any party.....

THE CHAIRMAN: Not on its own initiative.

MR. FENERTY: Not this Board, pardon me.

THE CHAIRMAN: Or any other Board.

MR. FENERTY: I think there is another section which says so.

THE CHAIRMAN: That did not come in until 1942.

MR. FENERTY : Pardon?

THE CHAIRMAN: That did not come in until 1942.

MR. FENERTY: Perhaps I am wrong. I do not want to clutter up the question with anything that might be debatable.

Q A rate which can be reviewed under certain circumstances and which was competent to the parties, to the contract, to have reviewed, I think there is no dispute about that part. And that that rate in turn forms part of the rate fixed by the Public Utilities Board, which the Gas Company is permitted to charge the consumer, with the result that the consumer has provided the $7\frac{3}{4}$ cents paid to the Royalite Company through the Gas Company

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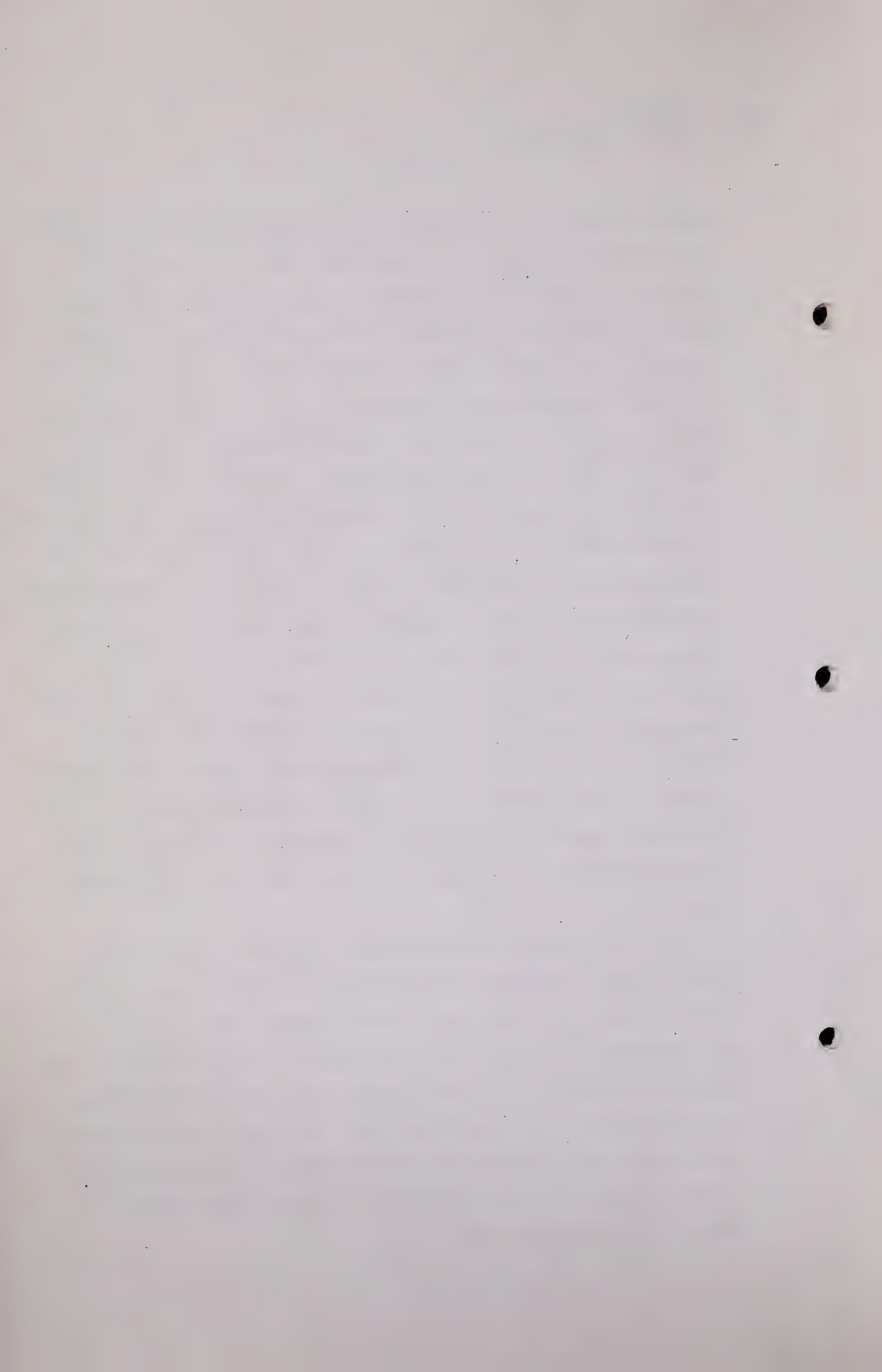
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instead of directly, would you think that that might be a moving circumstance whether or not this Board for all practical purposes, if not actually legally, under regulation, for all practical purposes, has added the depreciation that is taken provided by the public and the utility rates, would you think that was a situation that perhaps might alter this picture as perhaps a utility coming under regulation for the first time?

A Well, whether or not the Royalite Oil Company in the operation of this gas property, and the particular method of the maintenance of its accounts, was in operation under regulation or not under regulation, in my view that is ^ayes or no, perhaps, answer, which this Board will decide, or somebody will decide, and that hardly seems proper for me to make a suggestion in that regard.

Q Let us put it this way. Would it influence your view of the propriety of allowing these charges to remain where they have been placed by the Royalite Company if you learned that the rate paid by the Gas Company to the Royalite Company would have been the subject matter of inquiry, if apparently not satisfactory to all concerned, and could have been dealt with by the Utility Board?

A I am not particularly impressed with that point of view for this reason, that the Royalite Oil Company received a price of $7\frac{3}{4}$ cents at times when its depreciation charges with regard to the gas property were high, than when those same charges or equivalent charges were low, and I would rather fancy that in determining the propriety of the amount involved, that they were concerned with a straight calculation of accounting which may or may not have had regard to the depreciation at which they happened to take it in their accounts.



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I perhaps should go this much further, Mr. Fenerty, in order perhaps to explain the thing which you have in mind, that is the amount of money they take for depreciation and charge on the Royalite books is not necessarily the amount which they have recovered from the consumer through the Gas Company for depreciation.

Q Tell me something, Mr. Hamilton, why do you even call these charges we are discussing "depreciation charges"?

A Because that is the charge booked by the Royalite Oil Company as depreciation charges.

Q What do you mean by "depreciation"?

A Loss of physical value due to wear and tear, in the operation, of the elements.

Q And have those things that you are calling "depreciation charges" any relationship to wear and tear and all these other things you have been talking about?

A Yes, I would think so, but the measure may be different.

Q But the charges have no relation whatever to the wear and tear?

A I do not say that they have no relation.

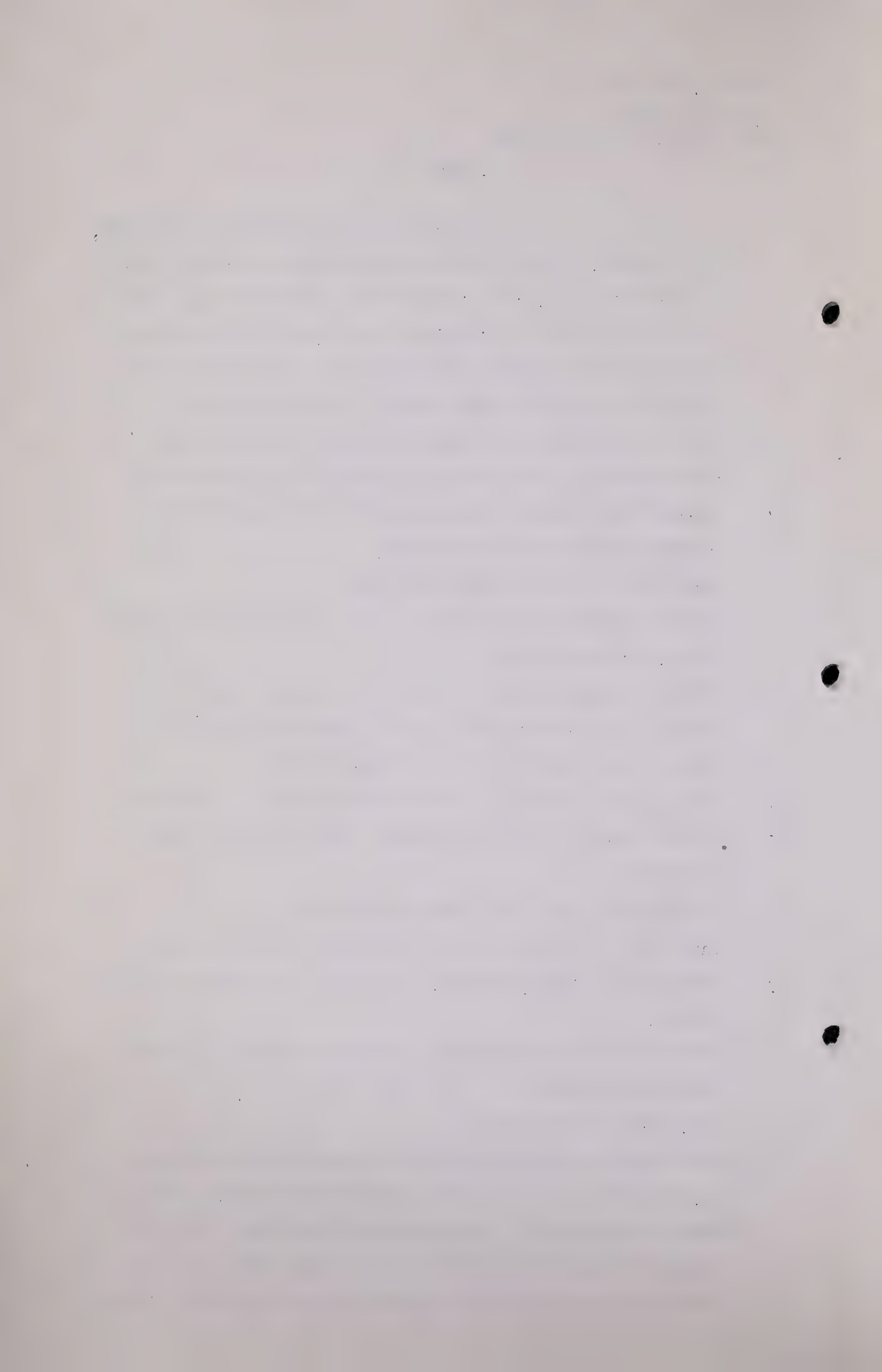
Q They have this relation that you call it "depreciation".

A That is so. That is right. It is an investment retirement scheme.

Q And they have some relation to wear and tear, the amount set by the company.

A Yes, that is the result.

Q Now I want to refer you to a statement that you made to Mr. Chambers, and on which apparently you and Mr. Chambers were in agreement. In Volume 47 at page 3688. At the bottom of page 3687 and the top of page 3688, you were referring to reasonable depreciation and then this question



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was asked you on the top of page 3688:

"Q. And when I am referring to that I am referring - let us take the 10 per cent ceiling that the Department works on. You would say that what the Department allows is a fair test of reasonableness.

A. I would think so, and when I say "reasonableness" I would still use that term to cover depreciation provision that might be even two or three times what the theoretical optimum figure might be. You are going to keep on the conservative side and I think it is proper that you should do so."

Now I will repeat that. "And when I am referring to that, I am referring - let us take the 10 per cent ceiling -"

That is income tax.

A. That is a question is it, Mr. Fenerty?

Q. Yes.

A. Right.

Q. "You would say that what the Department allows is a fair test of reasonableness."

You see what you said there?

A. I qualified that.

Q. Yes, I read that. I read the whole thing.

A. Right.

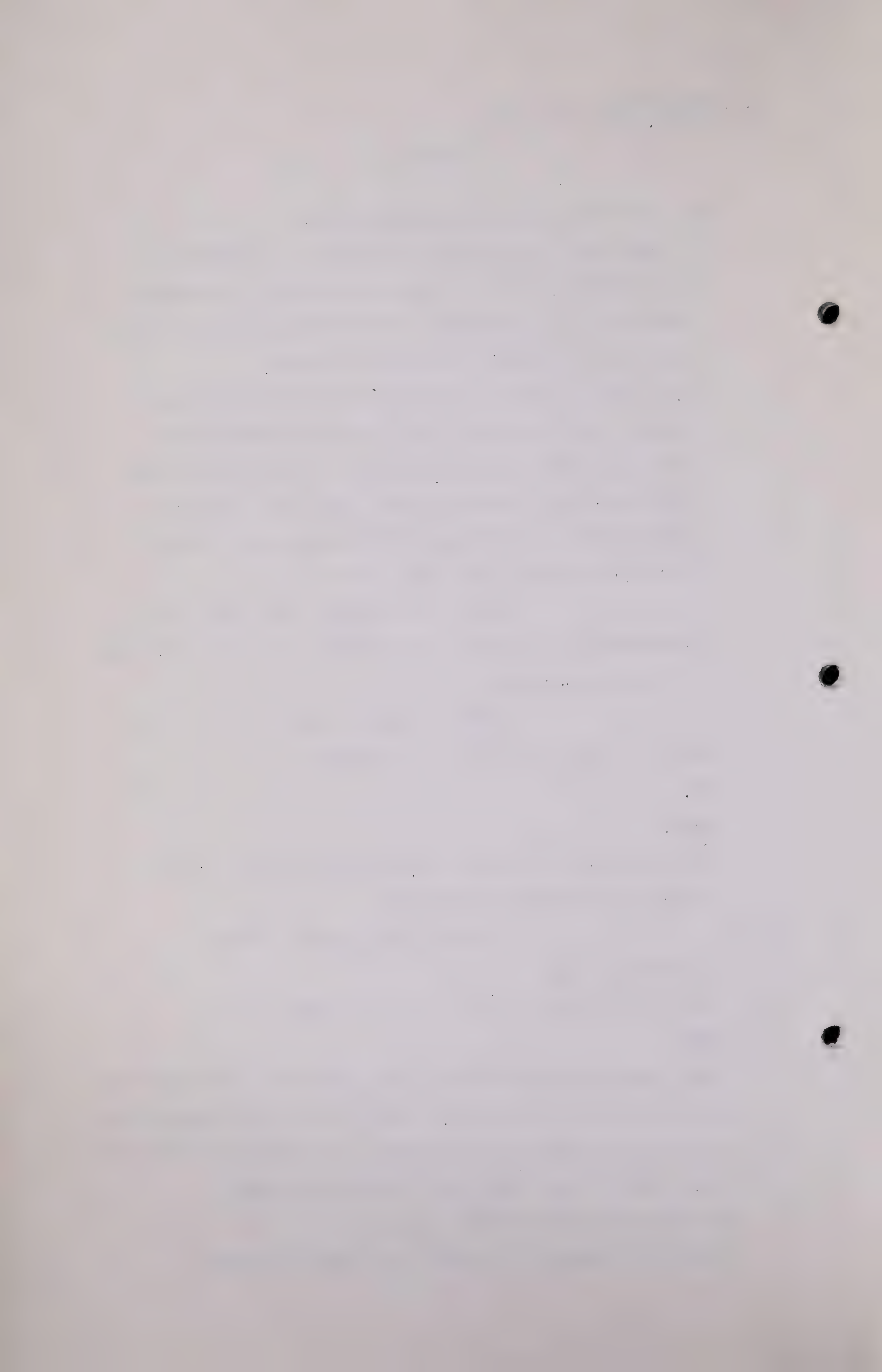
Q. And I gather you are saying there that what the Department allows is, in your opinion, a fair test of reasonableness.

A. Yes, but not the only fair test of reasonableness though.

Q. Yes. But it is a fair test of reasonableness.

A. On the upper side in most cases.

Q. And do you happen to remember Section 49-2 again?



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"The Board in fixing such prices or values shall determine the just and reasonable allowance for depreciation."

The reason I was interested in what you said to Mr. Chambers was that you and Mr. Chambers apparently used the words of the section "reasonable allowance". The Act provides for the Board fixing a just and reasonable allowance and this question and answer says that what the Department allows is a fair test of reasonable allowance. So apparently the Department allowance, being a reasonable allowance, would work out in the same way as a yardstick that the Board should use.

A No.

Q That was the test of reasonableness, you say, what the Department allows. And then the Act says that the Board shall determine a just and reasonable allowance. Reasonable allowance. If what the Department allows is reasonable and if what the Board has to fix is a reasonable allowance, would not they have some relationship?

A Very little.

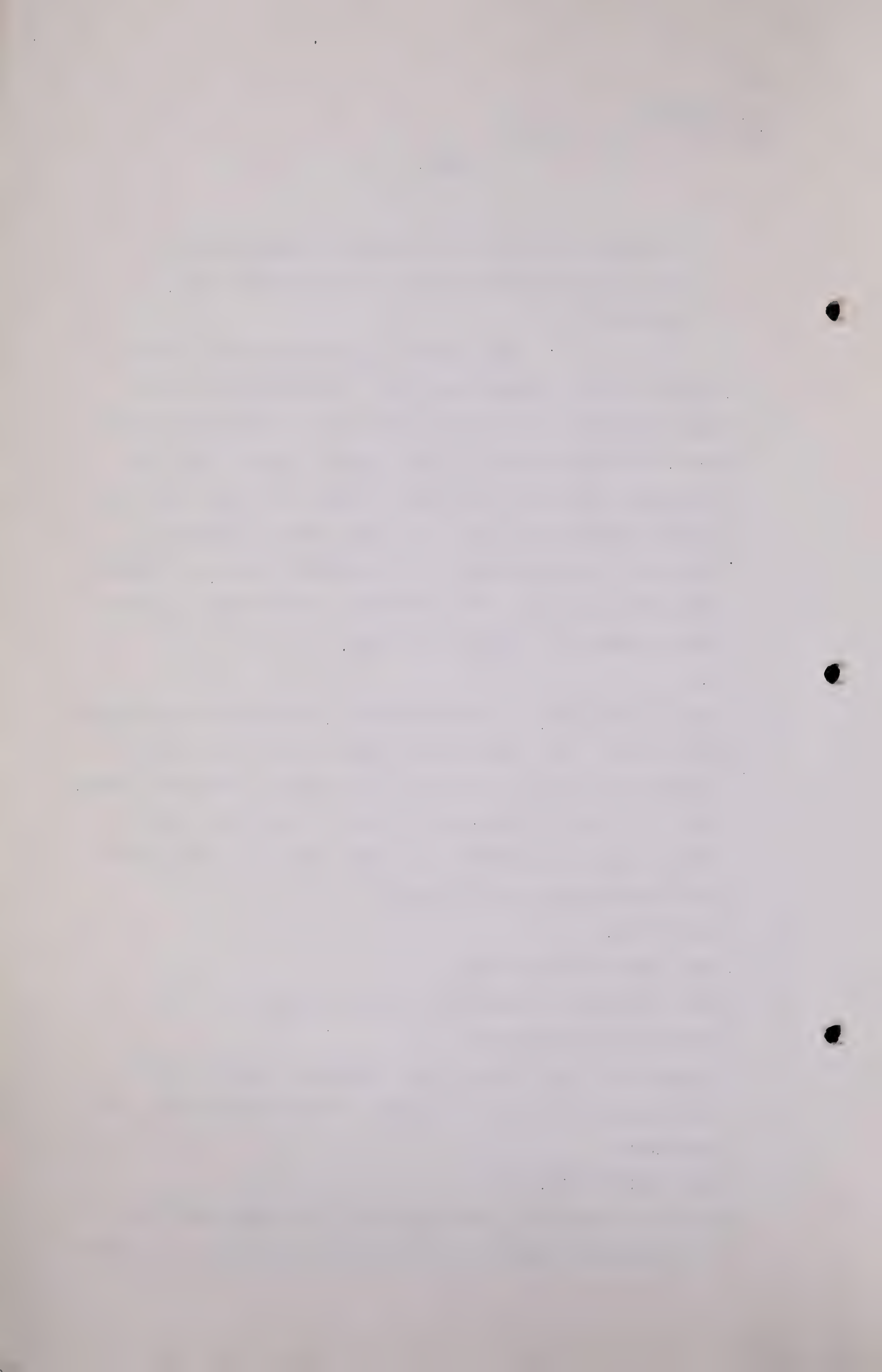
Q Just where is that wrong?

A Well, it might be reasonable for one purpose and quite unreasonable for another.

Q Is your idea that depreciation allowance should bear any relationship to wear and tear and these other matters you mentioned?

A Some relationship, yes.

Q One more question on that and then I will get away from it. As an accountant, if it suits your purpose in determin-



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ing the depreciation charges, you disregard entirely these items of wear and tear and the other items you mentioned. You do not give any thought to them?

A Beg pardon?

Q I say if it serves your purpose in determining depreciation charges, you disregard wear and tear, actual wear and tear, and these other items you told me were elements of depreciation?

A No, sir.

Q And in fixing the amount you do not arrive at the result on a fair appraisal of those items.

A As accountants, we consider the entries which appear in the books of the company and we determine whether that is reasonable or not.

Q But I am talking about your comments on the proper construction of that charge.

A Yes.

Q And if it has one object in view it is quite proper to fix these depreciation charges at much less than what might be thought to be the depreciation if you had another object in view. Is that correct?

A Properly qualified I believe that statement is correct.

Q And maintain both situations at the same time?

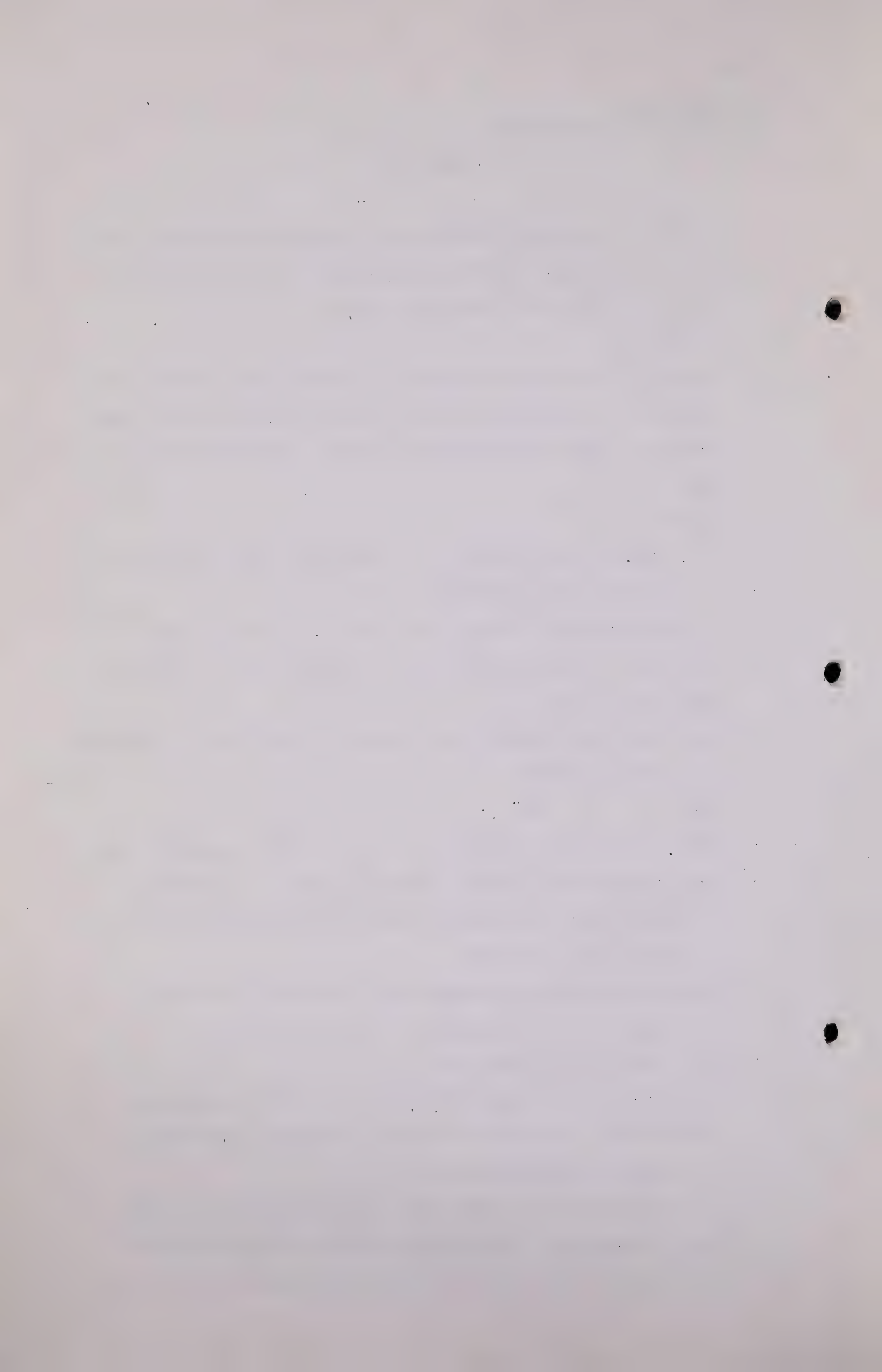
A For different purposes, yes.

Q And in the case of something that has served the public, whether under regulation or not, and even if it results in the public paying twice over.

A When it comes to be regulated. I would go that far, yes.

Q Well we understand each other, anyhow. So much for that.

A Pardon me, you did not say it was under regulation or not



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in the question or in the answer I gave.

Q Pardon me, that is not right, because if it were under regulation you say that situation would have been prevented.

A That is correct.

Q But where it is not under regulation and where as a result of the rate being fixed when it comes under regulation, the result is that the public pays for it twice over

A It might have that effect, yes.

Q Would you think that in trying to fix a just and reasonable allowance from the point of view of the public that it was fair and reasonable?

A That what was fair and reasonable?

Q That they should pay for it twice over?

A I am not suggesting that they are paying for it twice over.

Q But you say it might have that effect.

A Yes.

Q If it did have that effect would it be fair and reasonable?

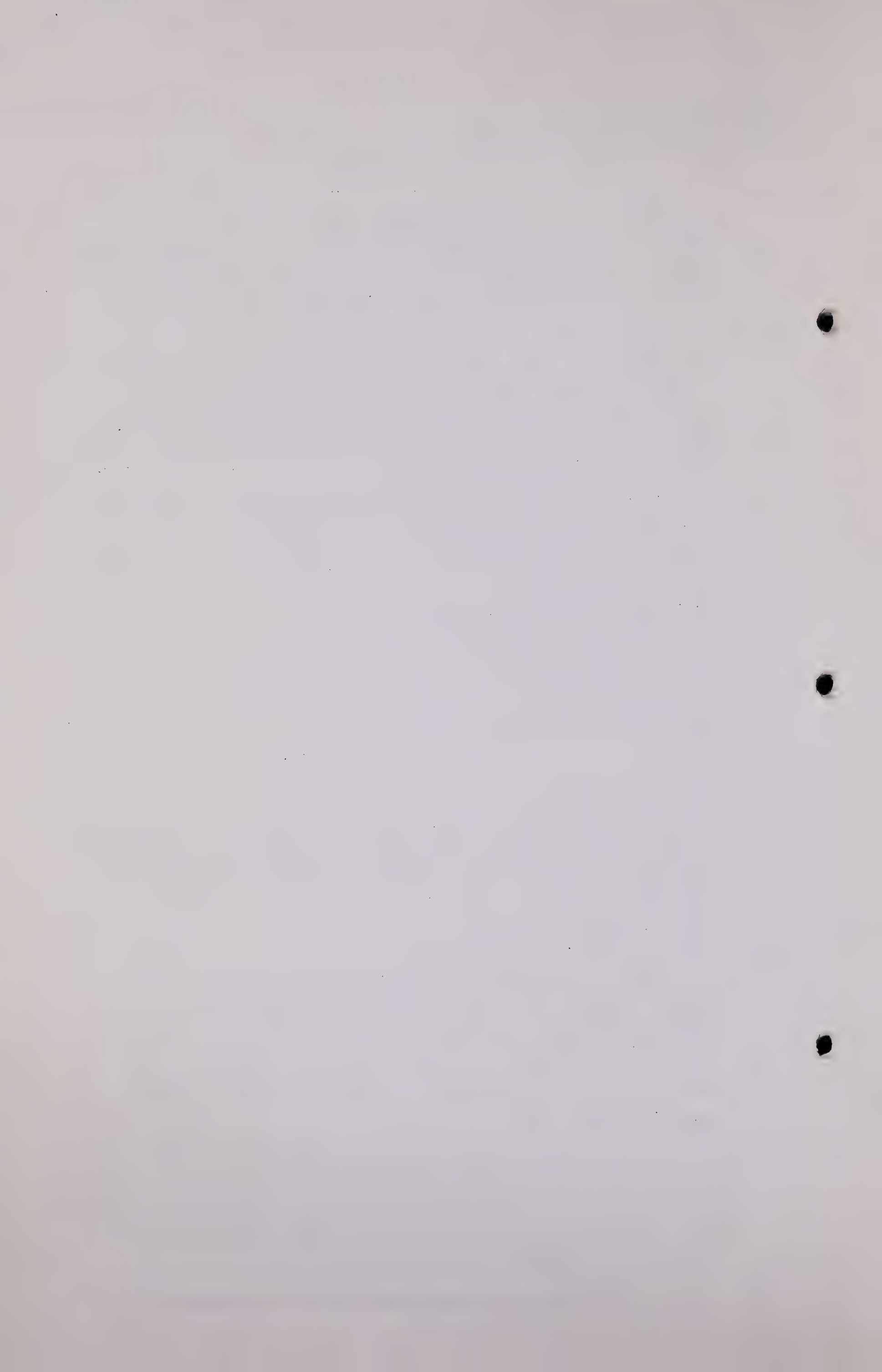
A It could be so, and it might not be in certain circumstances.

Q Depending on whether the company was under regulation for the first time.

A That and other considerations.

Q Well what other considerations can you think of at the moment, which would render it fair and reasonable for the public of Calgary to pay twice over for the gas that is used; not for the gas it has used but for the equipment used to supply the gas.

A Perhaps this is the point at which I would not agree with the statement that because the Royalite has booked a certain charge for depreciation that that amount has been recovered from the consumers of Calgary as depreciation. If the depreciation charge is excessive and should properly have



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been less, then all that means is that the Royalite Company earned more money in that operation than it appeared to have made.

Q I did not want to go into that but you will agree, won't you, that the Royalite Company, assuming for the moment the Royalite Company was a successful operation and perhaps you will remember we had evidence here that it was a successful operation.

A Right.

Q That the depreciation as set out in the books has actually been received by it. As I put it before, it is in its own corporate pocket in cash.

A No, sir.

Q It has got the money has it not?

A No, sir. Not for depreciation.

Q The Royalite Company got $7\frac{3}{4}$ cents in cash.

A Yes.

Q Now then, if the Royalite Company operated successfully as far as that gas operation is concerned, that $7\frac{3}{4}$ cents contains the depreciation which was charged in cash, does it not?

A Not necessarily.

Q If it is a successful operation?

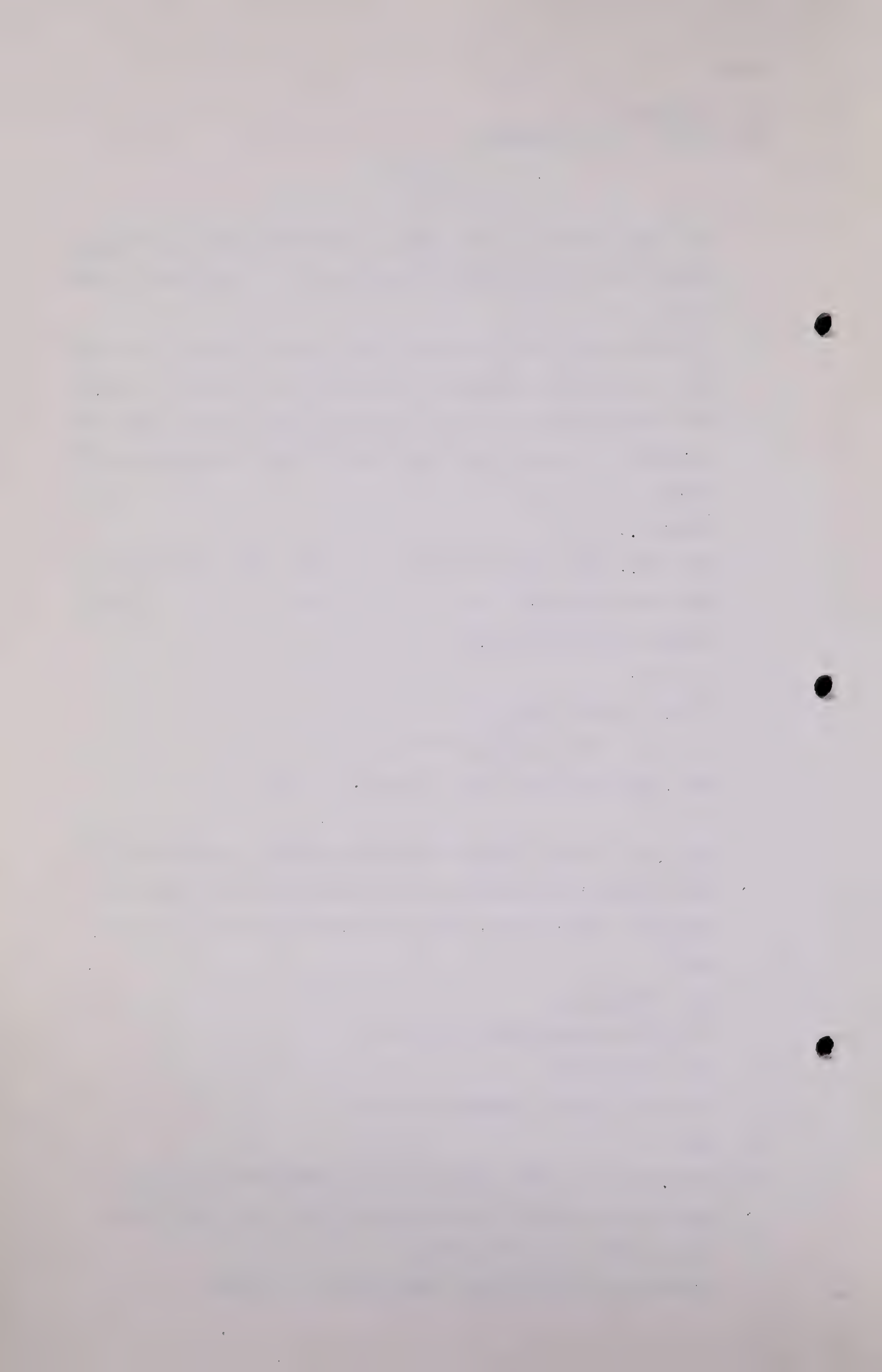
A Not necessarily.

Q It is not just a bookkeeping entry?

A Yes.

Q Even though it has a certain income from which it has deducted its booked depreciation, it has got that income in cash out of the $7\frac{3}{4}$ cents.

A It has got the $7\frac{3}{4}$ cents, that is all it has got.



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Q It has got the $7\frac{3}{4}$ cents in cash.

A That is right.

Q And then it takes out depreciation from that for income tax purposes?

A And for presentation of the published statement.

Q THE CHAIRMAN: It might have taken the $7\frac{3}{4}$ cents and divided it into different amounts and put it into different pockets.

A Yes, sir. It might have done it in half a dozen ways or a multiplicity of ways.

Q MR. FENERTY: But it got it?

A Yes.

Q It has got the money?

A Yes.

Q And somebody paid it that money.

A That is correct.

Q And it got it out of that $7\frac{3}{4}$ cent rate and that rate was in turn provided by the public was it not?

A You say it got that out of the $7\frac{3}{4}$ cents. What do you mean by "that"?

Q That is part of the $7\frac{3}{4}$ cents.

A What is "that"?

Q The depreciation it has charged is part of the $7\frac{3}{4}$ cents.

A Not necessarily. No necessary connection.

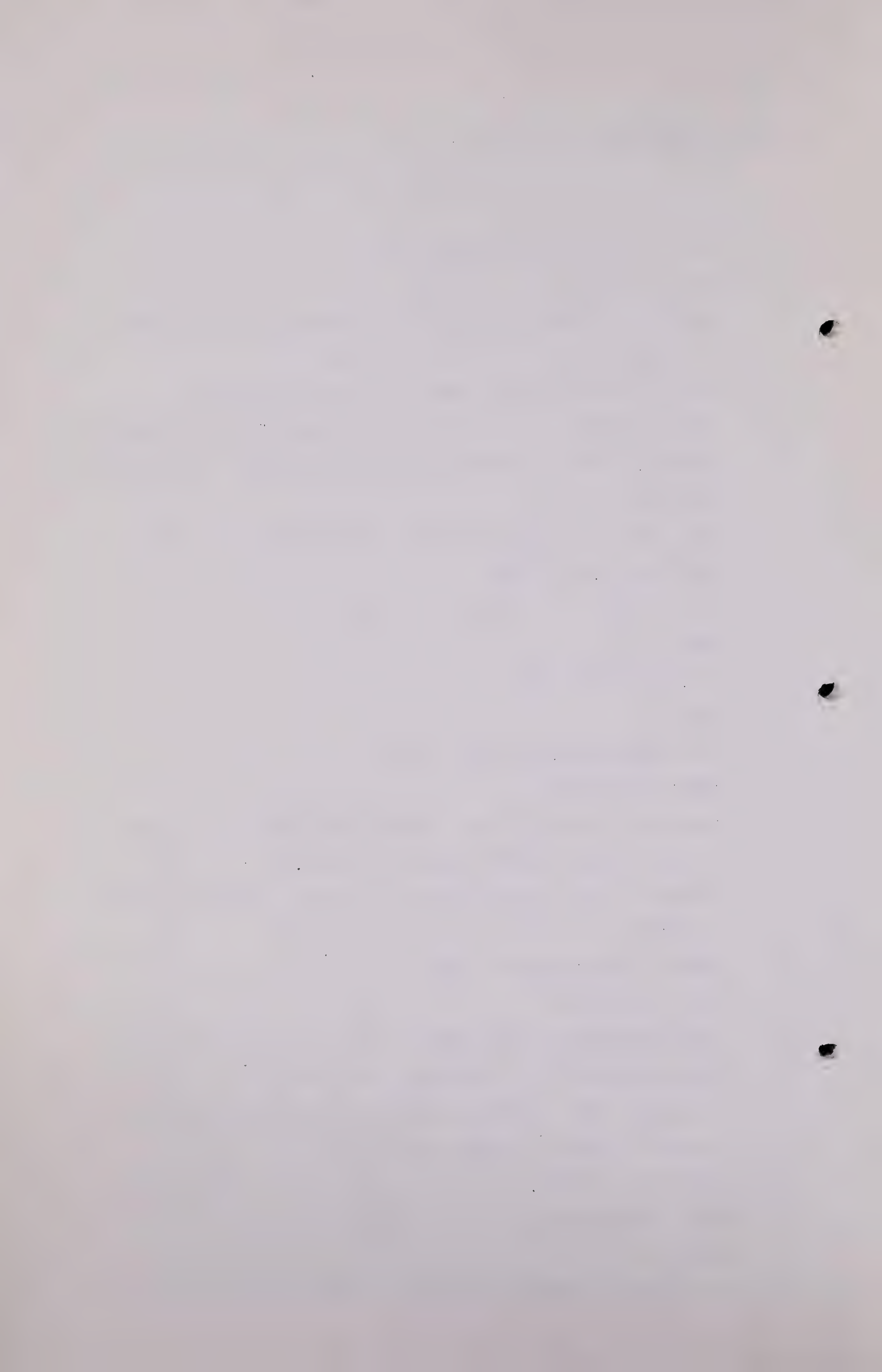
Q It has not eh? As far as income tax purposes are concerned, it got it in cash did it not?

A Got what in cash?

Q This depreciation.

A No.

Q If it is a successful operation. You see what I mean, a



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successful operation, it has made a profit. And this is the money out of which it takes this depreciation and puts it in one of these pockets you are talking about, is that not right?

A No, sir.

Q Perhaps I am wrong. It has made a profit over and above the amount of its depreciation.

A For tax purposes.

Q Listen to this, made a profit over and above. It has made in cash an amount of money which is over and above its operating charges and the expense it charged to operation over and above the amount of depreciation charged for by it in the books of the company. It has got that in cash has it not?

A Are you asking me to assume that?

Q Yes.

A I will assume it but I do not necessarily agree with it.

Q I may be wrong and the Royalite Company may never have made a profit. But assuming it has made a profit over and above its operating expenses and in excess of its depreciation charges.

A As booked?

Q Yes.

A All right, I will assume that.

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Q Then it follows that it has had in cash in its pocket the amount which it has charged for depreciation, has it not ?

A It has in cash the amount which it receives less the amount which it paid out.

Q And that includes the depreciation ?

A No, because it did not pay the depreciation out.

Q I did not say it paid it out. I said it had it in its pocket. If it paid it out it would not have it, it has in cash, if it has made a profit over and above its depreciation, it has the amount it charged for depreciation in one of those pockets, that is right is it not, in cash ?

A It has in cash the amount of its reported profit plus its book depreciation, I will agree with that.

Q I am not interested in any other. I am interested in the book depreciation, it has in cash and the Royalite Company - -

A I will not agree with that Mr. Fenerty, it has an amount equivalent to that but it is not the amount for depreciation.

Q All right, it has an equivalent amount in cash ?

A All right.

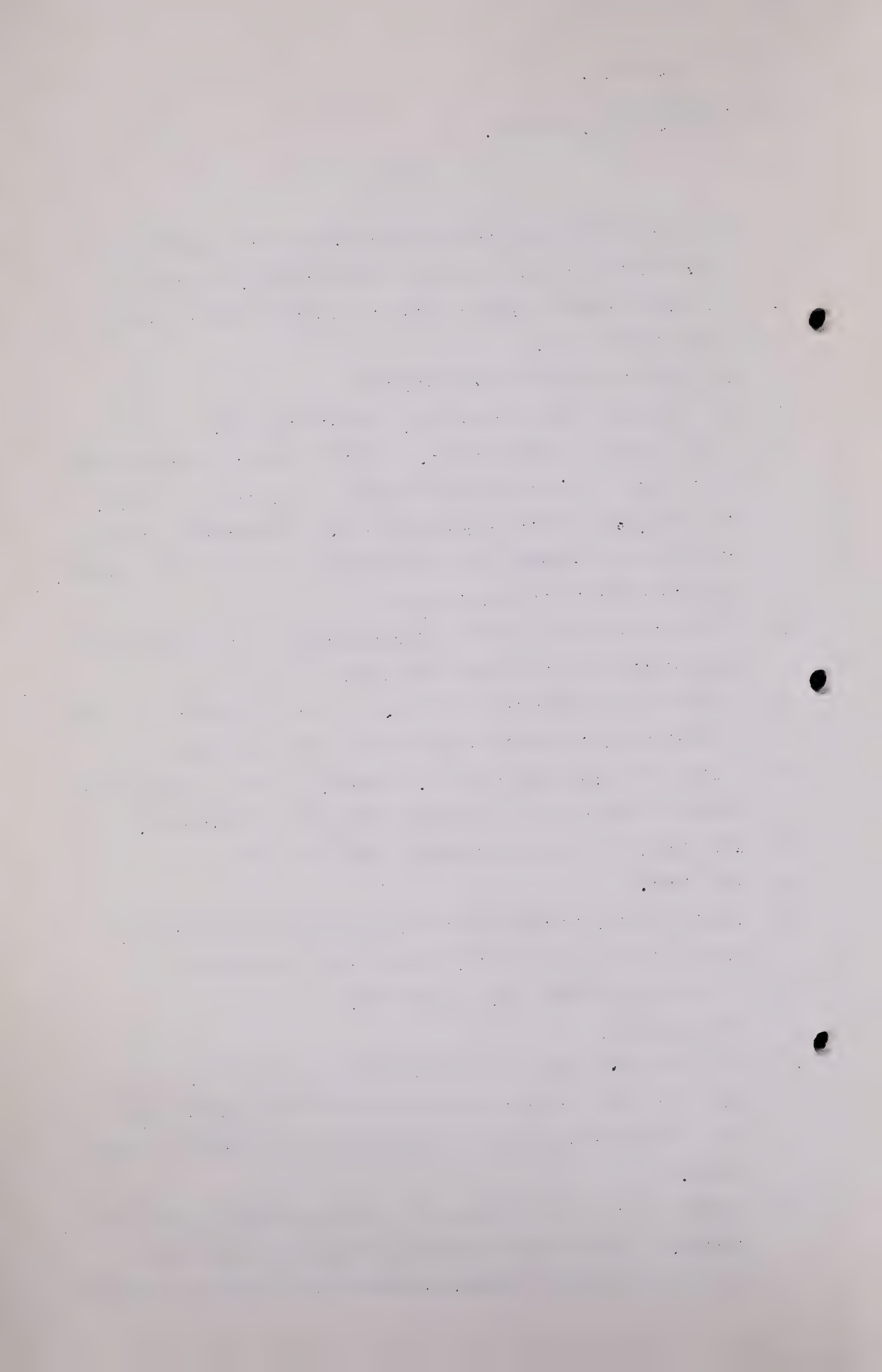
Q And it has it, if the Royalite was in that happy position, it got it from the public, through the Gas Company - -

A I would not go that far, Mr. Fenerty.

Q You will not ?

A I say they got seven and three-quarter cents and what they have left out of that is the seven and three-quarter cents less the proper charges and less the current capital expenditures.

Q We will put it this way then, you would not say it was depreciation. On the other hand if the Company that got that amount set aside in a depreciation fund, the amount it charged



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and continued to do so, you see, until it fully depreciated its assets and then it decided to wind up and go out of business, my understanding of the situation is that if that fund is distributed to the shareholders it is a return of capital, what do you say ?

A You are injecting a new concept there Mr. Fenerty, which is not - -

Q Is that so, is that your understanding ?

A I want to make sure I understand your question, you now put it on the basis of them putting an amount equivalent to their depreciation charge into a depreciation fund in cash.

Q And just that amount ?

A And thereby earmarking that out of the rate as being the amount they are recovering for depreciation.

Q Yes.

A In which case I agree with you.

Q And it corresponds with the amount they have charged up for depreciation ?

A That is right.

Q And for that to be a return of capital it has to correspond with the amount they charged up for depreciation ?

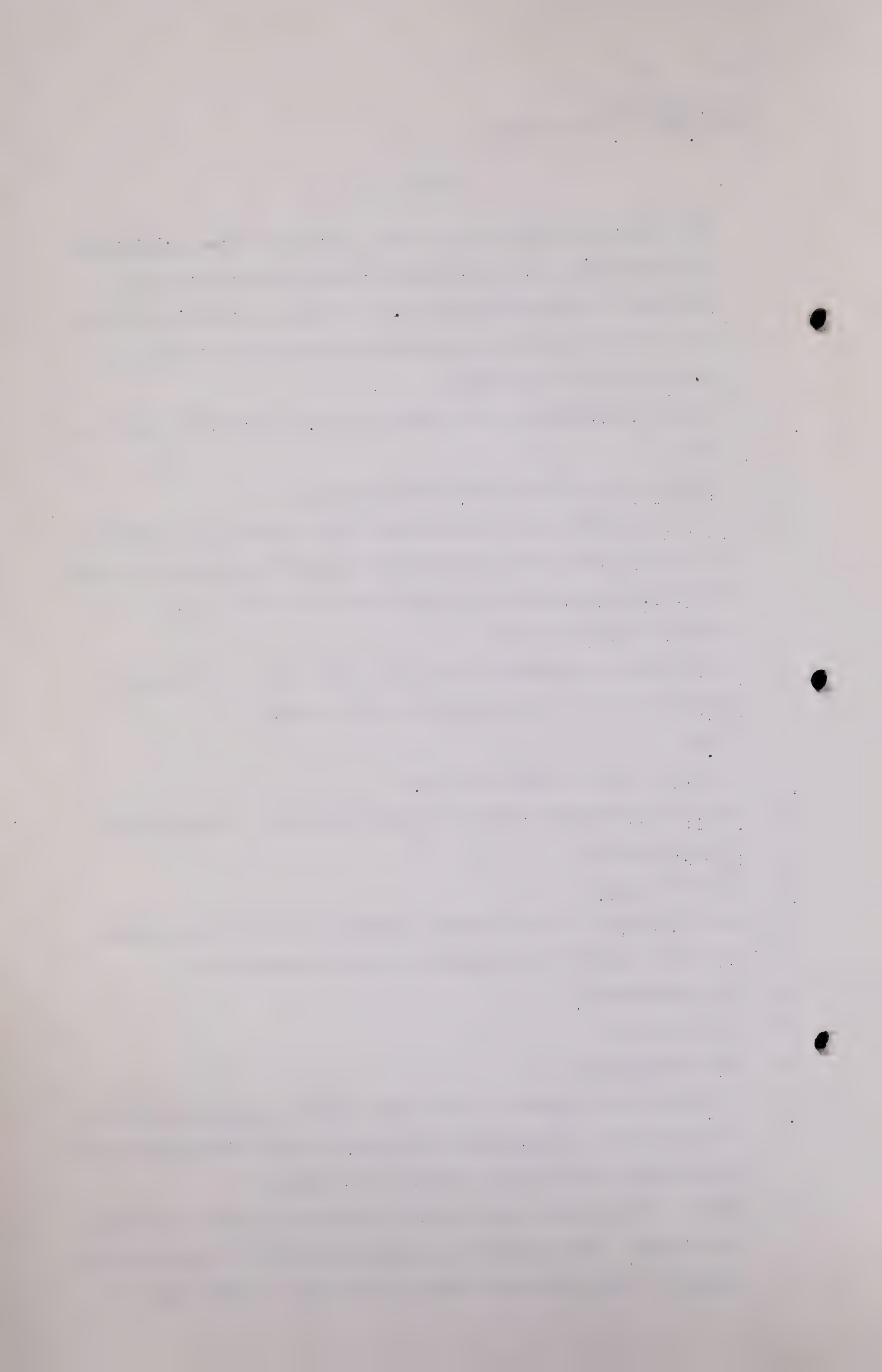
A Not necessarily.

Q Does it not ?

A Not necessarily.

Q If there is an amount in that fund which is substantially in excess of the depreciation estimated, do you think they could distribute that by way of return of capital ?

A Well I do not know what they can distribute by way of return of capital. That would be a legal question to be solved with regard to the particular facts of the case at that time. I



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would not care to generalize on it.

Q We will leave it then. Is the situation, with the various figures which you have submitted, is the situation this, that if the rate base is determined on the basis of historical cost, book cost, with depreciation fixed on the basis that has been taken by the Royalite Company on its books, the final result is this figure 789 thousand odd.

A Yes.

Q I see.

MR. FENERTY: And you will remember, - that is all I had to ask on this phase of it, Mr. Chairman, - you will remember that before Mr. Hamilton concluded his evidence he did put in Part 9 of the Report because Mr. McDonald wanted to get some evidence on it and I take it that it is the intention to conclude this first part first.

THE CHAIRMAN: I would think so.

MR. FENERTY: It is on a separate part altogether.

THE CHAIRMAN: I would think so.

MR. FENERTY: Yes.

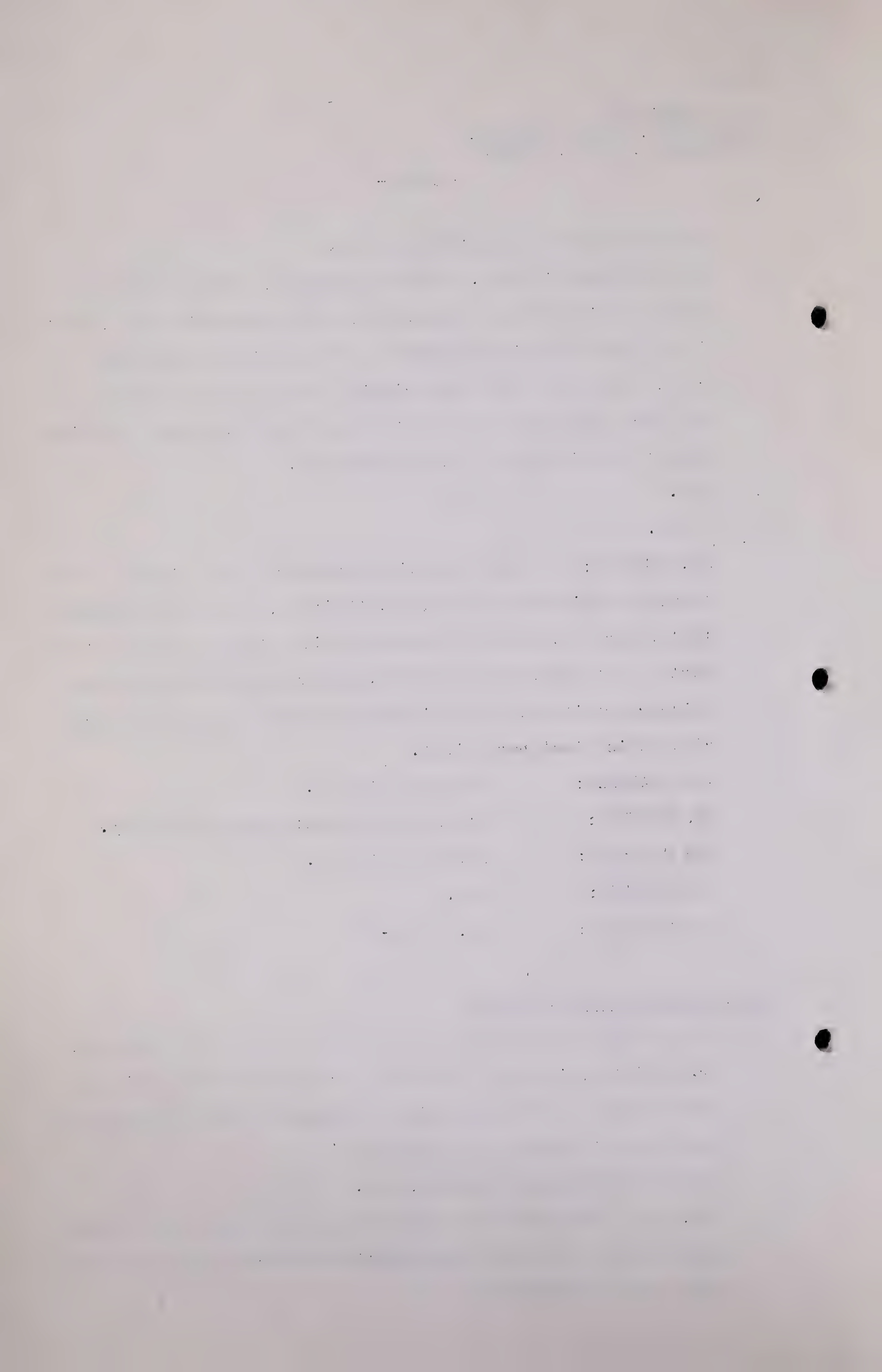
THE CHAIRMAN: Mr. Steer.

CROSS-EXAMINED BY MR. STEER:

Q I understand your view on depreciation for this undertaking, Mr. Hamilton, is that it should be computed on the basis of the throughput of the Gas plant as compared with the estimated reserves still to be put through ?

A For the main bulk of assets, yes.

Q Yes, and I understand the reason you suggest that that is the proper way to treat the depreciation is because of the limited life of the undertaking ?



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A Yes, it delimits the usefulness of the asset.

Q The idea being that the capital assets are going to last longer than the life of the undertaking ?

A For those assets so treated.

Q Yes.

A Yes.

Q And that your view is that an undertaking with a continuing supply would have its depreciation calculated on an entirely different basis ?

A Quite. The denominator becomes infinity.

Q That is right, and that is all I have.

THE CHAIRMAN: Mr. Harvie.

MR. HARVIE: I have just a question or two but I would like to hold my cross-examination until later.

THE CHAIRMAN: Mr. McDonald ?

MR. McDONALD: I have no questions.

THE CHAIRMAN: Any further cross-examination on this phase ?

MR. CHAMBERS: I wonder if I might ask Mr. Hamilton one or two questions this morning ?

THE CHAIRMAN: Yes.

CROSS-EXAMINED BY MR. CHAMBERS:

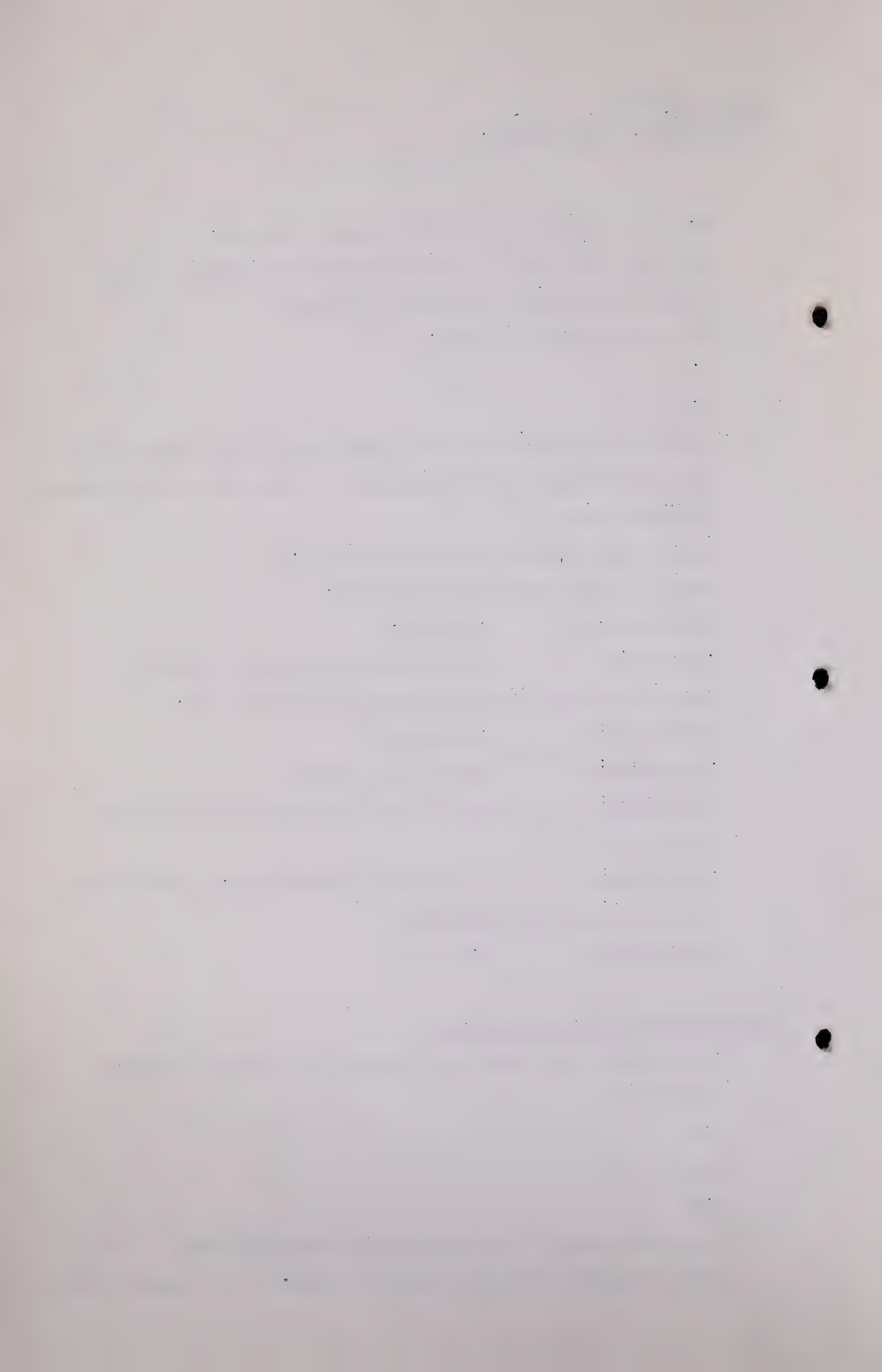
Q Mr. Hamilton, you heard the evidence of Professor Stewart, did you not ?

A Yes.

Q You were here ?

A Yes.

Q You will remember I put to him the proposition that, - and I think he agreed with me, - that the profits of a Company which



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were amassed or acquired in the conduct of the business prior to regulation should not enure to the benefit of the new consumers, or the consumer after regulation, and by the same token, the consumers after regulation should not be asked to make up the losses prior to regulation, would you agree with that proposition ?

A Yes. I think the proposition is better stated with regard to the utility company being able to keep its profits and not being able to transfer its losses.

Q Now I suggest to you that this question of book depreciation is, - where the book depreciation is charged up prior to regulation, - should be the measure of depreciation in computing the rate base for the first time under regulation, is inestimably the same in principle as the matter of past profits, past losses and past profits, would you agree with that ?

A Yes.

Q And am I right in this that the matter of book depreciation is in effect what the Directors of the Company decide to take out of the net earnings of any particular year and allocate for retirement of the investment, is that right, that is so far as the Company accounts are concerned ?

A When you say "take out" you do not mean "take out in cash" ?

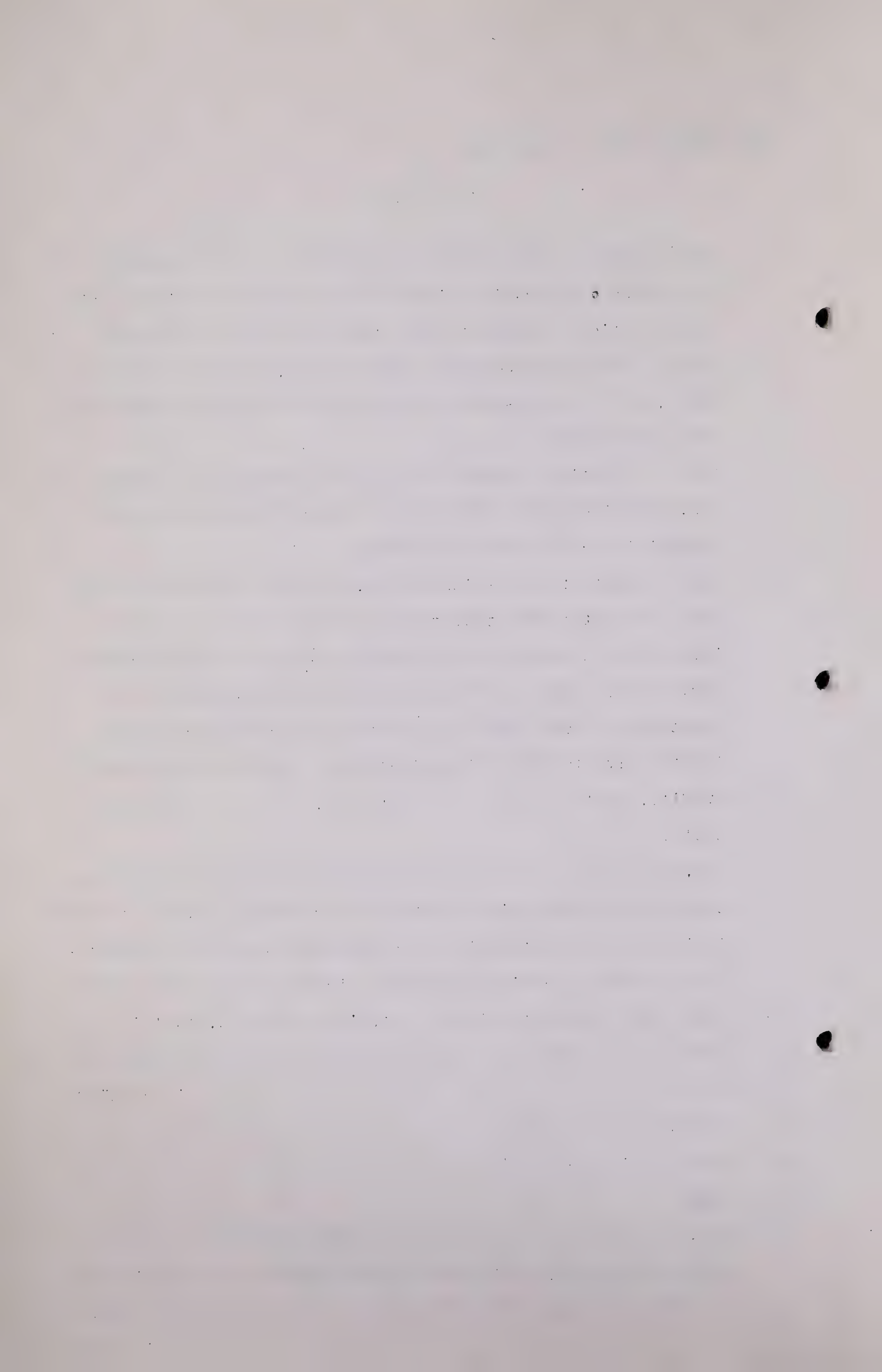
Q Oh no.

A You mean "deduct for" ?

Q Yes.

A Yes.

Q And that, to you, it is quite a common practice in business generally that the Directors do not measure the amount they are going to take out by the actual wear and tear of items of



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that nature, of the assets themselves ?

A Oh I would think, sir, generally speaking that the depreciation charged unless it is especially qualified, has some relationship to wear and tear and probably will err on the conservative side and further than that I think you have to take the depreciation policy as a whole. As I understand it the Royalite Oil Co. reporting a particular depreciation charge covering all its assets whether in a particular category they have over-depreciated, if they have and they have under-depreciated elsewhere and I would not be at all surprised if the Directors would take this attitude "The Department will allow us what we think is less than what we think we are entitled to in one respect and will allow us more elsewhere but taking them altogether it comes to an adequate charge". I think that feature must be taken into account and that the depreciation charge must be taken as a whole, this being an integrated undertaking, as a whole.

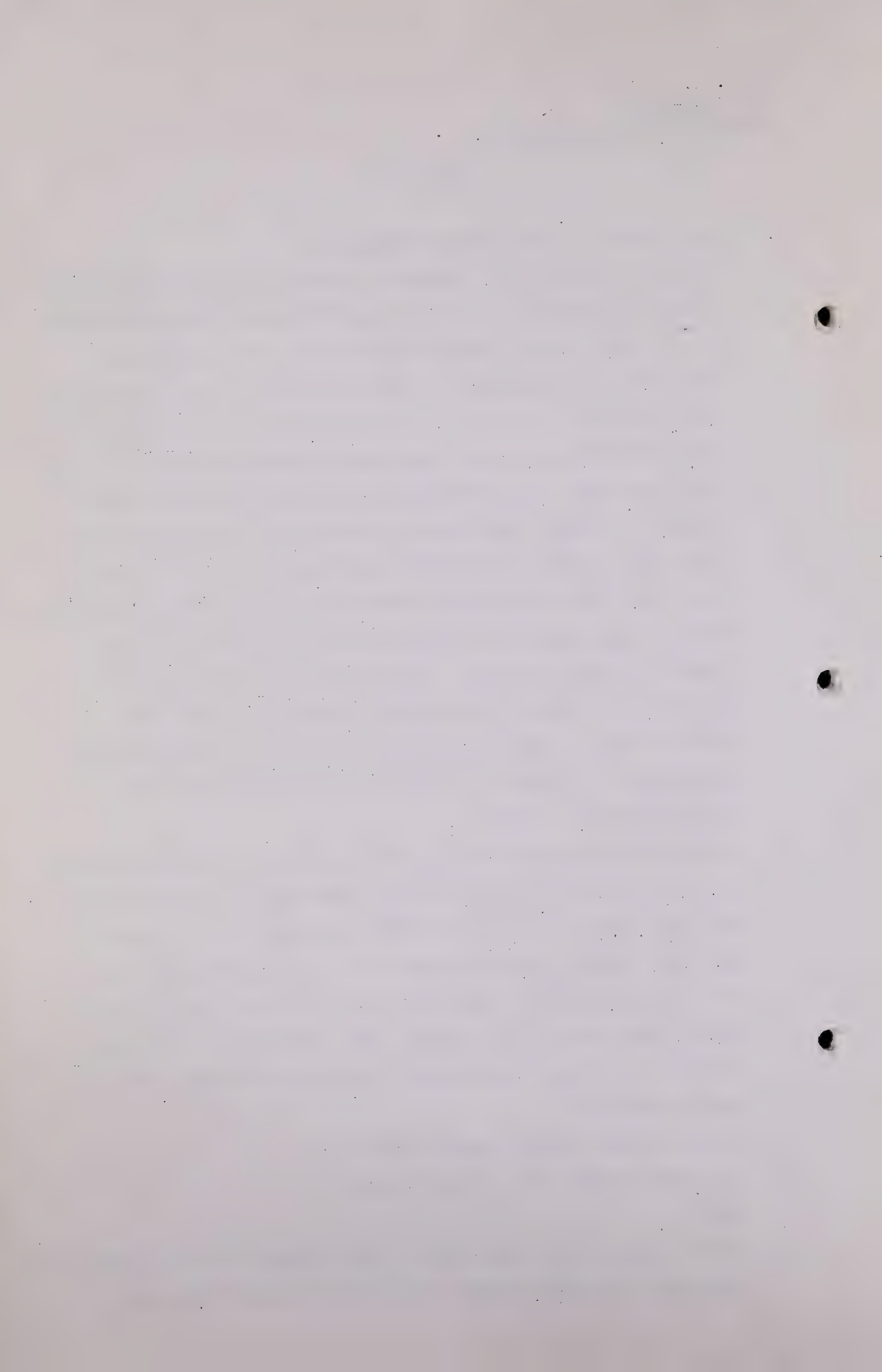
Q I was going to bring that out later, but if a Company, as you say, has carried on its particular business prior to regulation, just one Company, and did no other business, as the auditor for that Company you would take the view, I understand, that it is the duty of the Directors, as evidenced by the accounts, to at least see that the amount they had charged for depreciation is as much as the factor of depreciation is, would you agree with that ?

A As much as the actual depreciation.

Q Yes, bona fide they should do that ?

A Yes.

Q And as long as they take care of that minimum then the additional amount which they charge up is more or less absolutely in



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their discretion ?

A I would not go quite that far, Mr. Chambers. They would be entitled to a reasonable measure of conservatism but not to be unreasonable.

Q Now as I understand it, the Income Tax people say that for the purposes of computing income on which you pay income taxes, you cannot allocate more than a certain amount of your income to depreciation, is that not in effect what they say ?

A More than a certain amount of the cost of the assets against the current income.

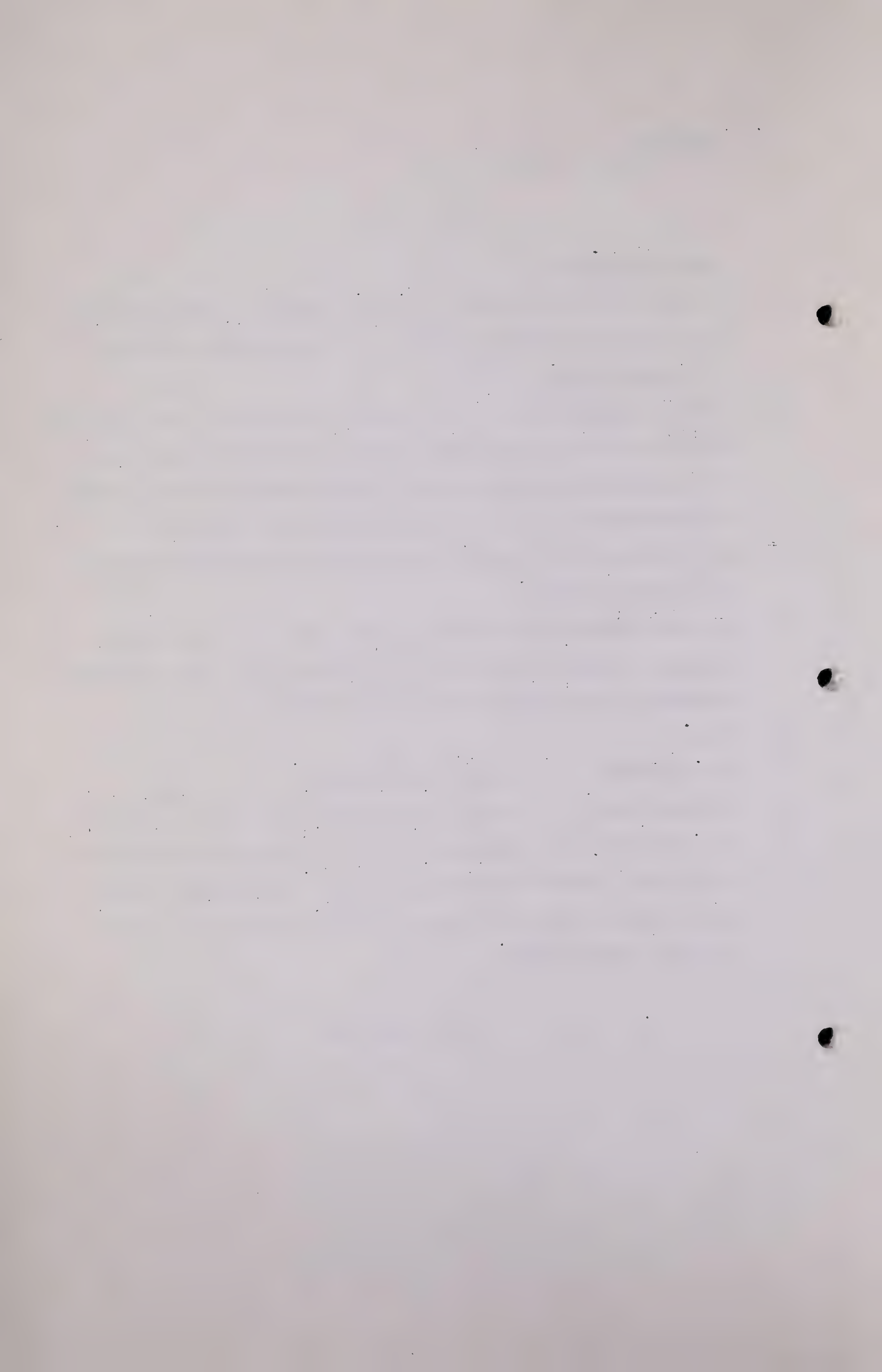
Q And that depreciation policy in the past, of a particular company, assuming they have been conservative, just diminishes the amount of their net stock by that amount ?

A Yes.

MR. CHAMBERS: That is all I have.

THE CHAIRMAN: Well will it profit you to cross-examine Mr. Hamilton with reference to the evidence which he gave to enable Mr. Zinder to give his evidence. Does anyone wish to cross-examine him on that phase of it, in the light of Mr. Zinder's conclusions.

(Go to Page 4601)



M-1-1 - 10.15 A.M.

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THE CHAIRMAN: What part is that of your report ?

A Part 9. I have one or two observations to make with regard to the use Mr. Zinder put on these figures but I am not prepared at the moment.

THE CHAIRMAN: I have to finish the rate base.

MR. BLANCHARD: As I understand it we won't be able to complete the British American rate base....

MR. HARVIE: The whole point Mr. Chairman is that Mr. Donellan will be here today and tomorrow. It is just impossible for him to be here next week and we do not wish to get half way through and I am sure no one else would want us to make a break and my suggestion was that we might go ahead with the Royalite operating cost and keep everything current in that way.

MR. CHAMBERS: Mr. Chairman, I did not make my preparations of that base because I certainly understood that the matter of rate base would be cleaned up first. Now I do not know that I have very much to ask Mr. Hamilton on the operating expenses, but I have not given it any thought and I thought Mr. Donellan was here this morning to deal with the British American rate base.

MR. HARVIE: There is no reason why we should not proceed and have Mr. Hamilton's evidence regarding our rate base even if Mr. Donellan is here.

THE CHAIRMAN: If we do not do that what is going to keep us going next week ?

MR. HARVIE: In any event by next week I suppose we would be into the Royalite and Madison operating expenses.

MR. CHAMBERS: Well I do not think that will take very much time and I would be ready to go on with it.

THE CHAIRMAN: We can go on with Mr. Mercer's cross-

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examination.

MR. CHAMBERS: I have not looked into that.

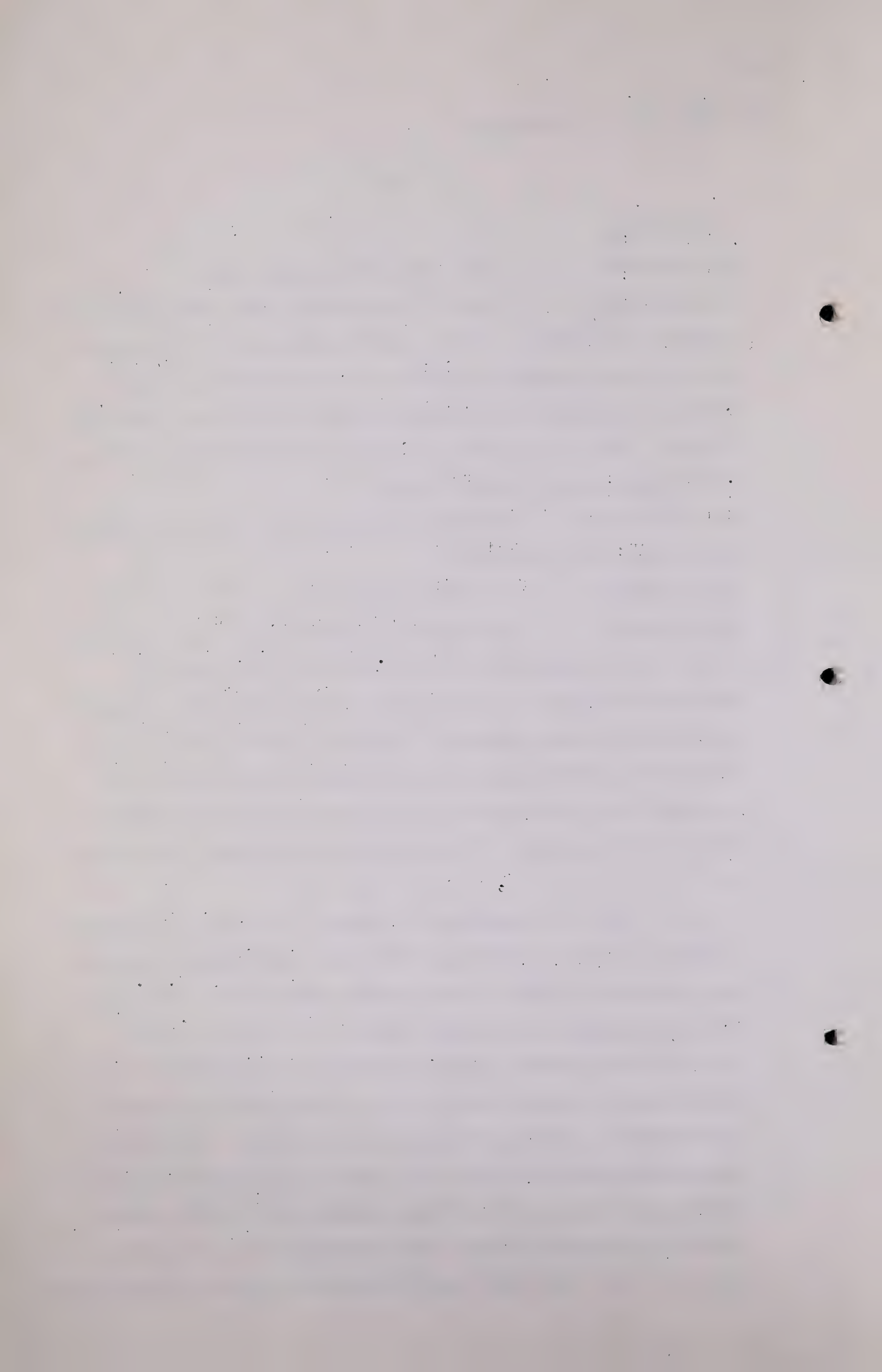
THE CHAIRMAN: Well I will tell you this Gentlemen, I am going to sit ^{next} Monday, Tuesday and Wednesday and I will expect to have some business to do and if I do not there is some evidence not going to be admitted simply because you did not bring it when you had the opportunity. I hope that is clear. We will go on with the rate base.

MR. BLANCHARD: The cross-examination as to Part 9 will not be proceeded with then ?

THE CHAIRMAN: Not at the moment.

A THE WITNESS: Commencing at Page 8 of Volume 2 (Exhibit 124), and statements WH 11 to 19 of Volume 1, pardon me Statements WH 13 to 19 of Volume 1. Here again, sir, a good deal of the factual material contained in our original submission is rendered obsolete by subsequent developments in evidence and I will endeavour to indicate the points of variance as we proceed. I am reading now from Page 8 of Volume 2.

The B. A. submission at Page 1, of Volume 2, suggests a total rate base at December 31, 1944 of \$893,121.07, should now read \$972,832.00. Of this amount \$703,736.00 represents new construction. That figure should now be \$786,437.00. \$4,789.29 represents automotive and office equipment. That figure should now read \$4,911.00, and \$184,595.50 represents high pressure gathering lines and water system, previously comprising part of the operating plant of the British American Oil Company Limited. That figure should now be \$181,483.00. Subject to eventual review, new construction is accepted as stated. And if you will recall it was the subject of examination



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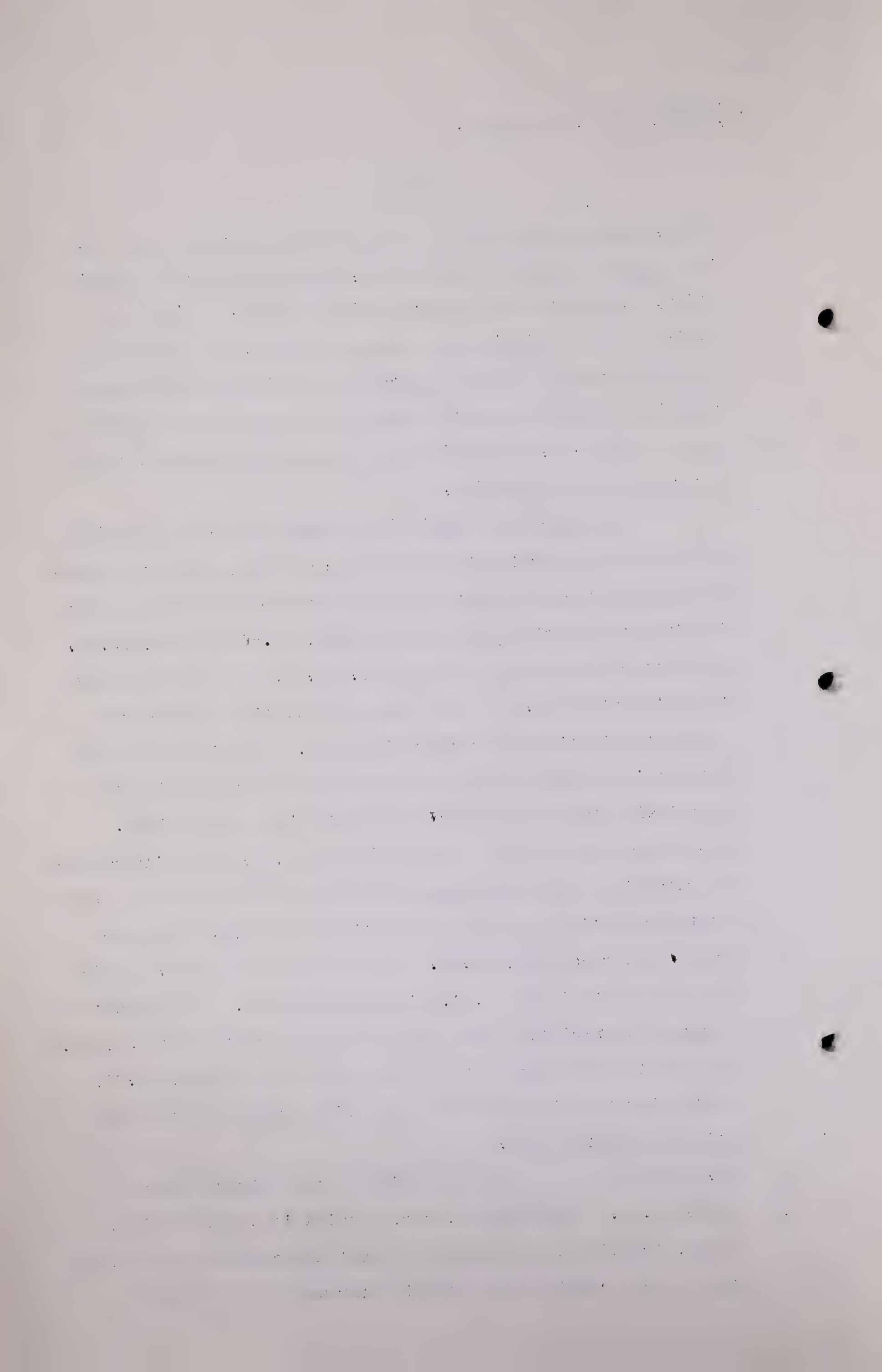
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of Mr. Donellan and most of the particular points I had in that regard were dealt with by Mr. Blanchard in cross-examination. Automotive and office equipment being in our view subject to the principle of alternative use, is reserved for appraisal comment. Value suggested for high pressure gathering lines and water station having previously been operated as part of the B. A. absorption plant system are however, in our opinion, open to question.

We therefore submit in Statement WH 13 a comparison of rate base determinations as at December 31, 1944 with regard to these particular assets, following various formulas resulting in net valuations ranging from \$30,574.86 to \$184,595.50. The latter figure should read \$181,483.00. We might now turn to Statement WH 13. We have here a tabulation of five rate base determinations in comparative form. The first of which set out in Statement WH 14 summarized on WH 13 as being the appraisal method less observed depreciation on materials. Total reproduction cost as appraised by K. R. Teis with respect to gathering lines and Company officials with respect to water system resulting in a gross valuation of \$222,408.25, which should now read \$219,296.51. A difference of \$3,000.00 which was dealt with in the B. A. direct submission. The amount of observed depreciation as I recall remains constant at \$37,812.00 so that the net depreciated value would now be \$181,483.76, that being the high point of the various rate base determinations presented here.

Q MR. HARVIE: Will you give me that figure again ?

A \$181,483.76. Incidentally, sir, I think it would be wise, safer, to eliminate entirely the last two columns of WH 13, so that we can confine our attention throughout to the old



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previously operated systems. All the information relating to the 1944 construction has been rendered obsolete since, so I am suggesting now that we eliminate entirely the final two columns of WH 13.

The Company's rate base determination contained in WH 15 is based on the historical British American Oil Company cost less their book depreciation. The historical cost in accordance with the schedules submitted as being in accordance with the books, which we have not examined. That is the books we have not examined, \$137,232.14, gross valuation less booked depreciation of \$106,657.28, resulting in a net valuation of \$30,574.86, which is the lowest of the rate base determinations presented here. The next determination as set out in WH 16 is based on historical cost as was the last preceding, so that the gross valuation, the same figure of \$137,232.14, but we have substituted for the depreciation as booked by the Company a revised accrued depreciation on throughput formula without salvage, resulting in a depreciation deduction of \$45,712.67 and a revised net depreciated value of \$91,519.47. The fourth determination is based on the gross valuation according to the appraisal method, that is the appraisal by Teis for the gathering lines and by Company officials for the water system resulting in a gross valuation of, as we have it here, of \$222,408.25, which should now read \$219,296.00, the difference being as in the first case, the same figure of \$30,011.00 which is explained in the submissions and applying to that appraisal gross valuation a throughput formula would result in a depreciation deduction of \$72,696.00 and a net depreciated valuation of \$146,600.00.

H-2-1 10.30 a.m.

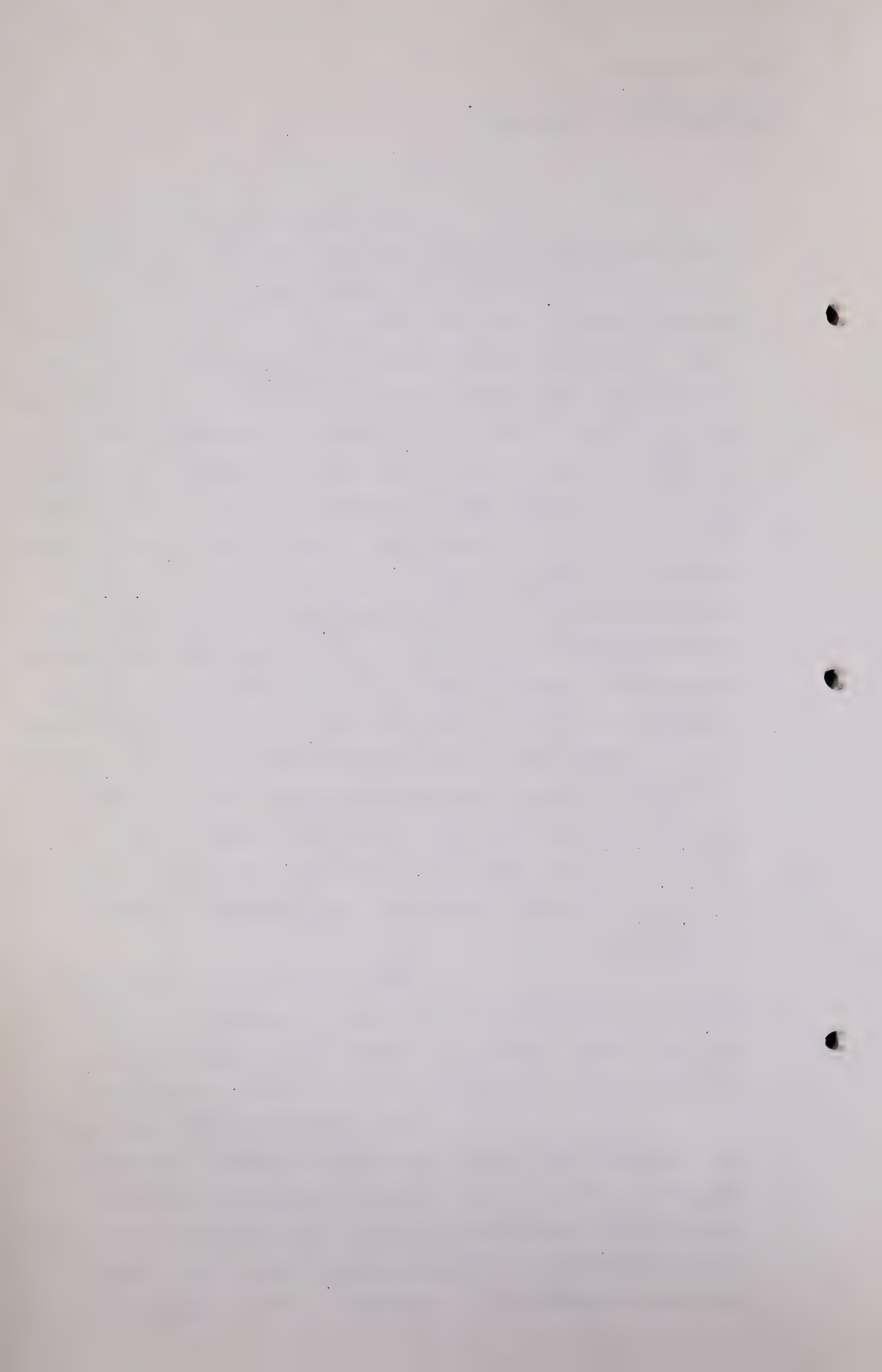
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The final determination suggested here is an adjustment, historical cost for gross valuation, with a throughput formula with salvage allowed set out in Statement W-H-18. The gross valuation is based on historical cost. The figure which we have used is the determination plus 10% allowance for general overhead, resulting in a gross valuation of \$150,955.36. From that in respect to depreciation there is deducted an amount of \$47,305.81, which is depreciated on throughput formula; allowing estimated salvage of 5% on gathering lines, and 10% on the water system, depreciation on the throughout basis applied at the average rates to depreciable balance. The net depreciated value on the final basis would be \$103,649.55. The recapitulation of these various bases, the appraisal less observed depreciation results in a net depreciated value of approximately \$181,000.00; the book value according to the information received from the British American Oil Company Limited \$30,500.00; historical cost less accrued depreciation approximately \$91,500.00; the appraisal less throughput depreciation approximately \$147,000.00; cost plus 10% for overhead, less accrued depreciation, with salvaged adjustment, a net depreciated value of \$103,600.00.

These various rate base determinations are summarized in W-H-13, and statements W-H-14, 15, 16, 17, and 18 merely contain the detailed information which is already summarized in W-H-13, which we have been discussing.

The depreciation table upon which the throughput depreciation rates were determined, contained in Statement W-H-19, will of course require correction in respect to any variations therefrom. There probably will be from the terminal reserve at December 31st, '43, as found by the Board and as guessed at by ourselves. The key figure is a



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reserve estimated to remain at December 31st, 1943, of 65 billion, 200 million cubic feet. That will be wet gas gathered.

Q Mr. BLANCHARD: Mr. Hamilton, does your figure for salvage in W-H-18, that is the 5% on gathering lines and 10% on water system, depend in any way on the period of pay-off? For instance, would you fix those percentages of salvage on the same basis whether the pay-off was in ten years or twenty-five years?

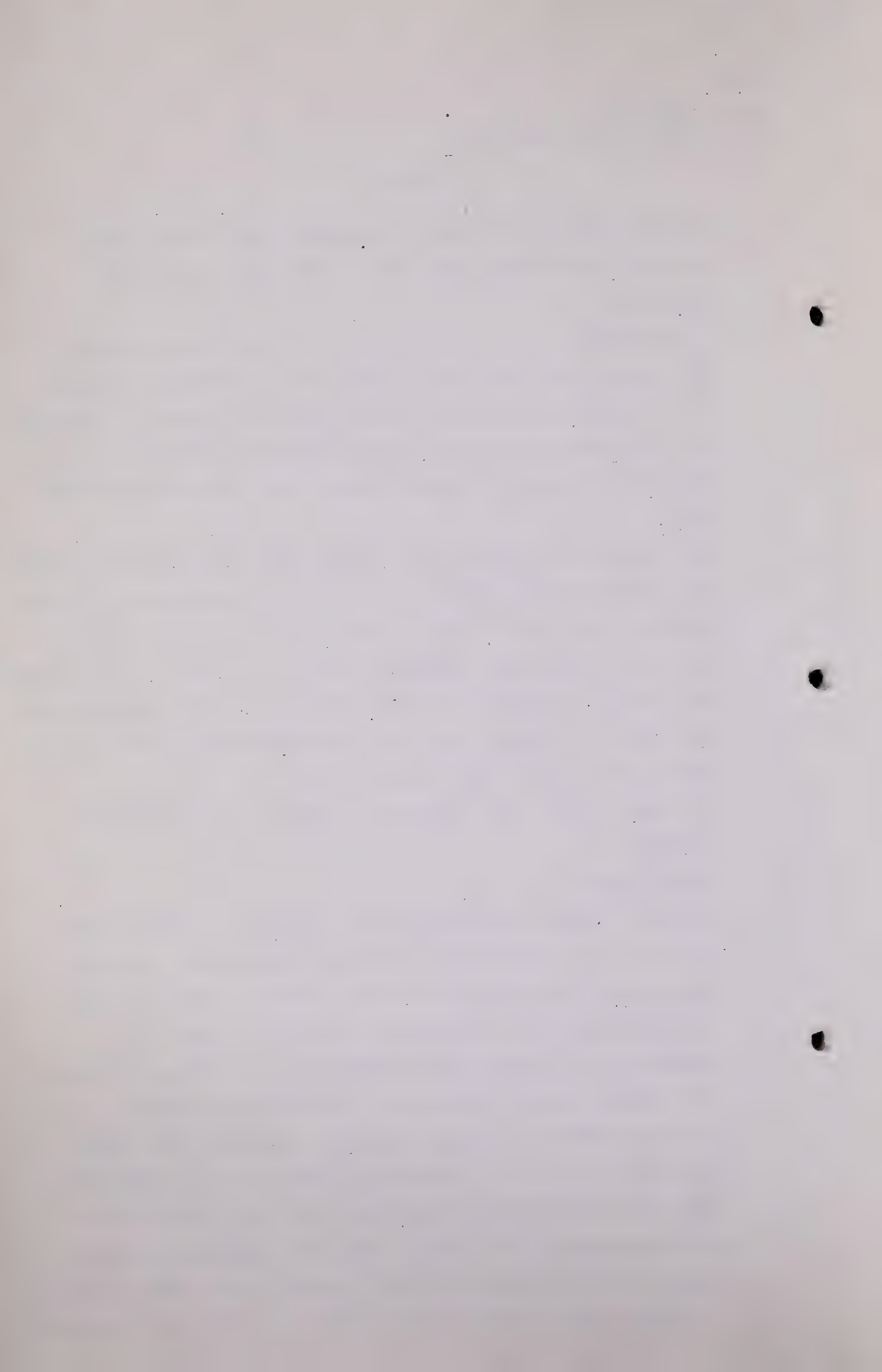
A Our information was that the deciding consideration with respect to salvage of such assets as would be contained in the gathering system, or the water system, would not be subject to a great deal of obsolescence. Consequently, it is a matter of determining what would be the cost of taking the lines out as compared with what could be obtained for them, and time did not seem to be an important element in that determination.

Q You base that on the evidence of several of the engineers?

A Yes sir.

Q Already given?

A Yes sir. There is possibly this remark that I should make, and that is in the case of the Madison situation. You will recall that the throughput formula applied to certain classes of assets, and that in particular their system was not depreciated on the throughput basis but on, I think, a 30-year life basis, whereas in the case of the British American it is suggested that the throughput formula applies to the water system as well as to the gathering lines, on the grounds that the water system will probably last the life of the British American segment of the field, and, consequently, throughput becomes a deciding consideration, whereas in the case of Madison it was felt that physical life of the water system was possibly



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more important than the life of the field.

I think, Sir, that covers what I had in mind with respect to the old gathering lines and the water system. I am not sure whether you meant me to deal at all with the question of 1944 and '45 installations.

Q Those are accepted at the figures given by Mr. Donellan?

A All of which has been the direct subject of review here.

Q Yes?

A And subject to our cross-examination.

Q Yes. I think there is no purpose in doing that.

MR. HARVIE:

Just excuse me a minute. Mr. Chairman, we have no cross-examination of Mr. Hamilton with regard to this stage of the submission. I would suggest that possibly this would be an appropriate place for us to give answers to questions that were asked in regard to Mr. Donellan's submission. I think it would just complete this phase of the submission, and would allow that information to be on hand for cross-examination later on.

THE CHAIRMAN:

That is, you suggest that we go on with the evidence of Mr. Donellan now?

MR. HARVIE:

Yes, at this stage.

THE CHAIRMAN:

And postpone any cross-examination by other Counsel?

MR. HARVIE:

I do not know whether there is any further cross-examination by other Counsel.

MR. BLANCHARD:

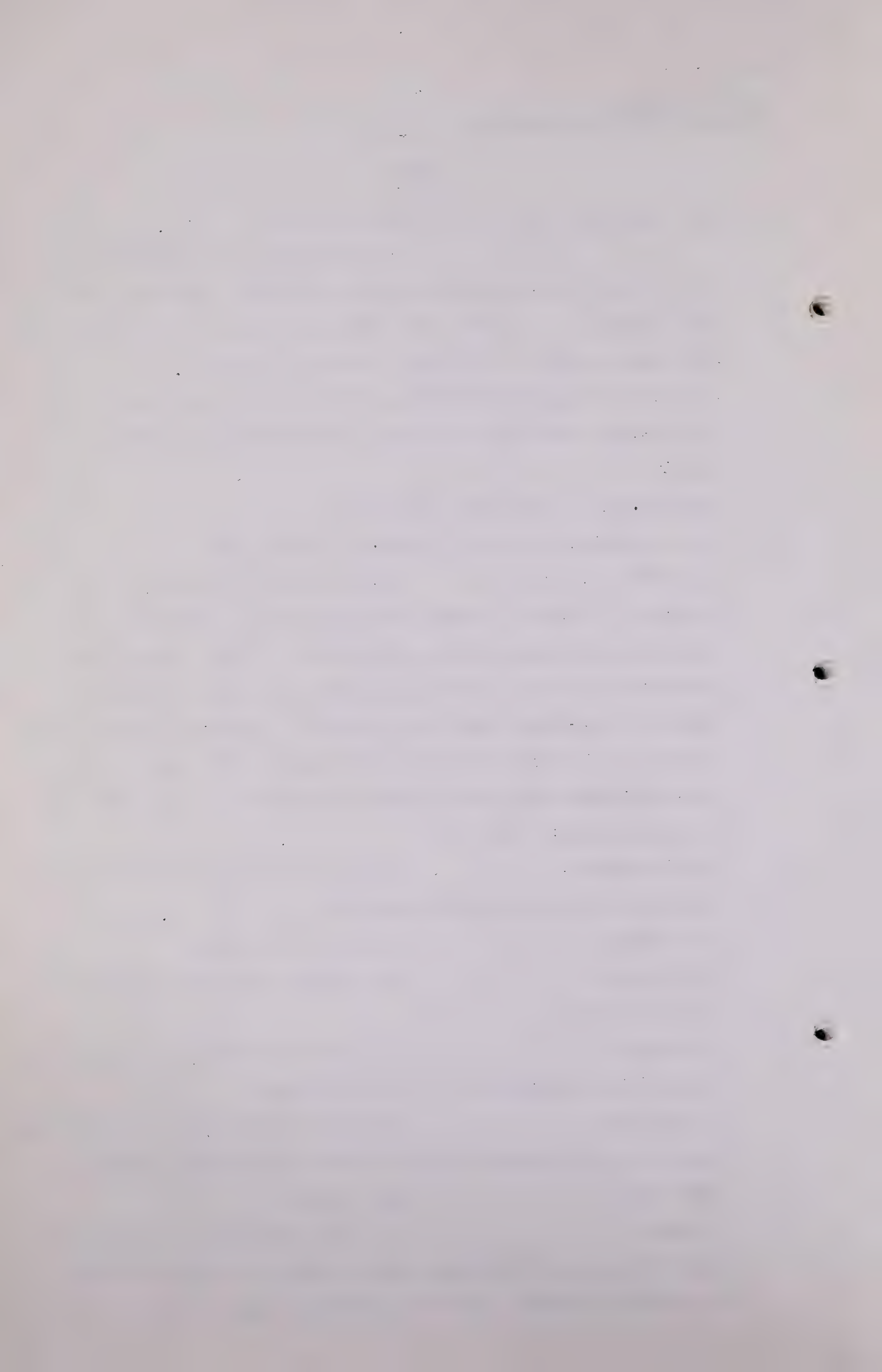
Hadn't we better finish the working capital of the British American before Mr. Donellan starts?

THE CHAIRMAN:

All right.

WITNESS:

We have dealt at a previous time with the method of computing working capital requirements for the Madison Company, and the principles lying behind the parti-



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4 cular method that was followed by us in our submission. Those comments are contained in our Volume 2 at pages 11 to 17, and in W-H-20, and Charts W-H-21 to 23 inclusive. The same principles that pertain to our appreciation of the British American ~~circum-~~
~~stances~~ ^{EXPENSES}, the method that has been followed is the same, and is contained in Statement W-H-24, resulting in a recommended working capital allowance of \$15,000.00, as compared with an allowance of \$20,000.00 suggested by the Company. I should make this qualification that our calculation of the fifteen thousand dollar allowance will be automatically revised upward or downward according as the operating expense estimates vary from actual. In other words, the calculations with regard to Madison, who have had a year's actual operating results, were before us in determining the net forecast to finance the undertaking, whereas in the case of the British American we were relying solely on the Company's estimates of what expenses it would incur, and, consequently, the amount of cash required to finance those expenses would likewise be a matter of estimate.

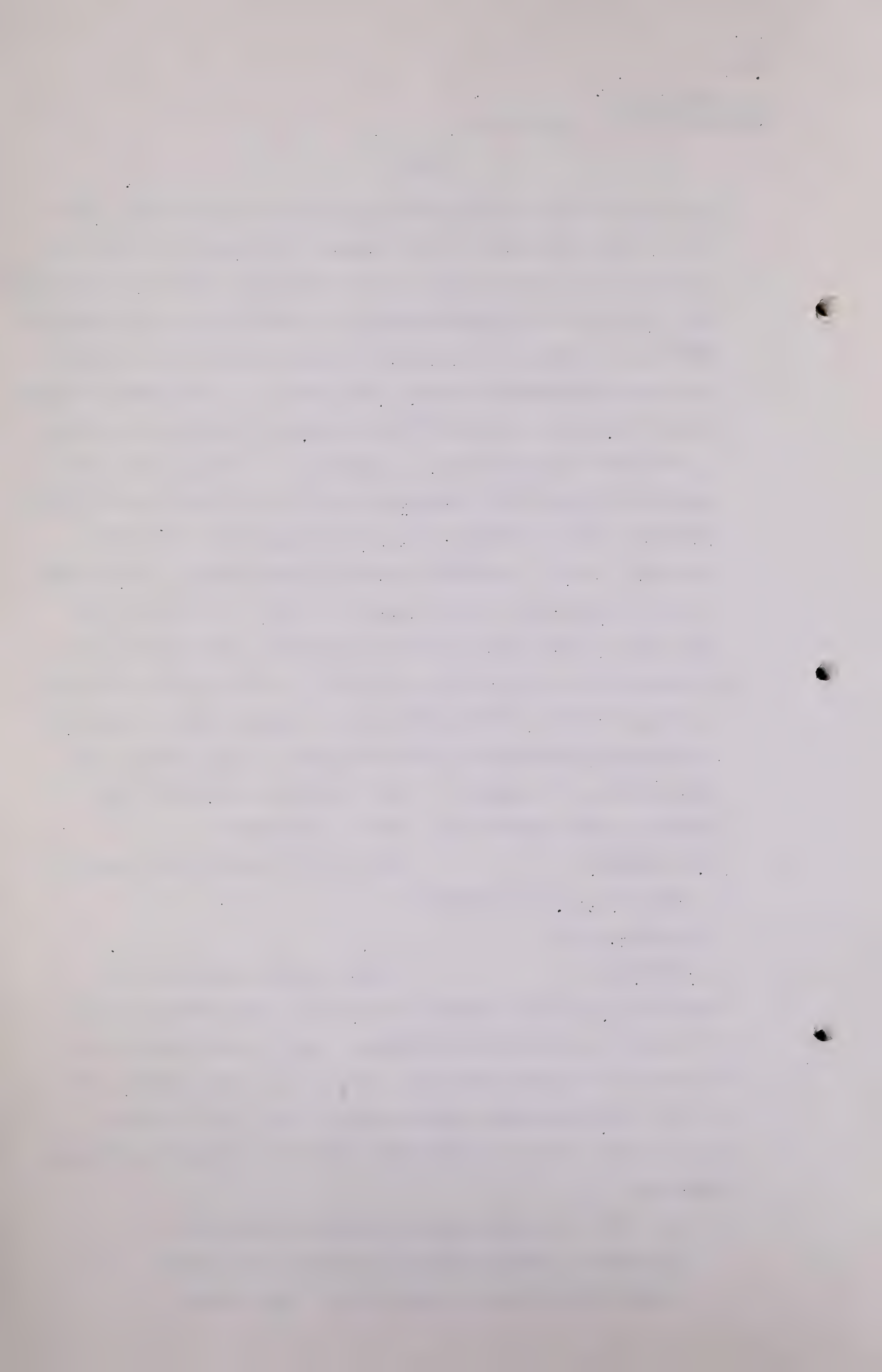
Q THE CHAIRMAN: Does that conclude your evidence, Mr. Hamilton, on this phase?

A I think so, Sir.

Q MR. HARVIE: I might just point out, Mr. Hamilton, that while you were reading the submission contained in Volume 2, regarding the Madison, you actually stopped at the end of the first paragraph, on page 17, and did not read the last two paragraphs which directly deal with the B.A.

A Well, at page 17, our submission reads, with respect to British American:

" The foregoing general considerations with respect to working capital allowance apply with equal force to British American. The company

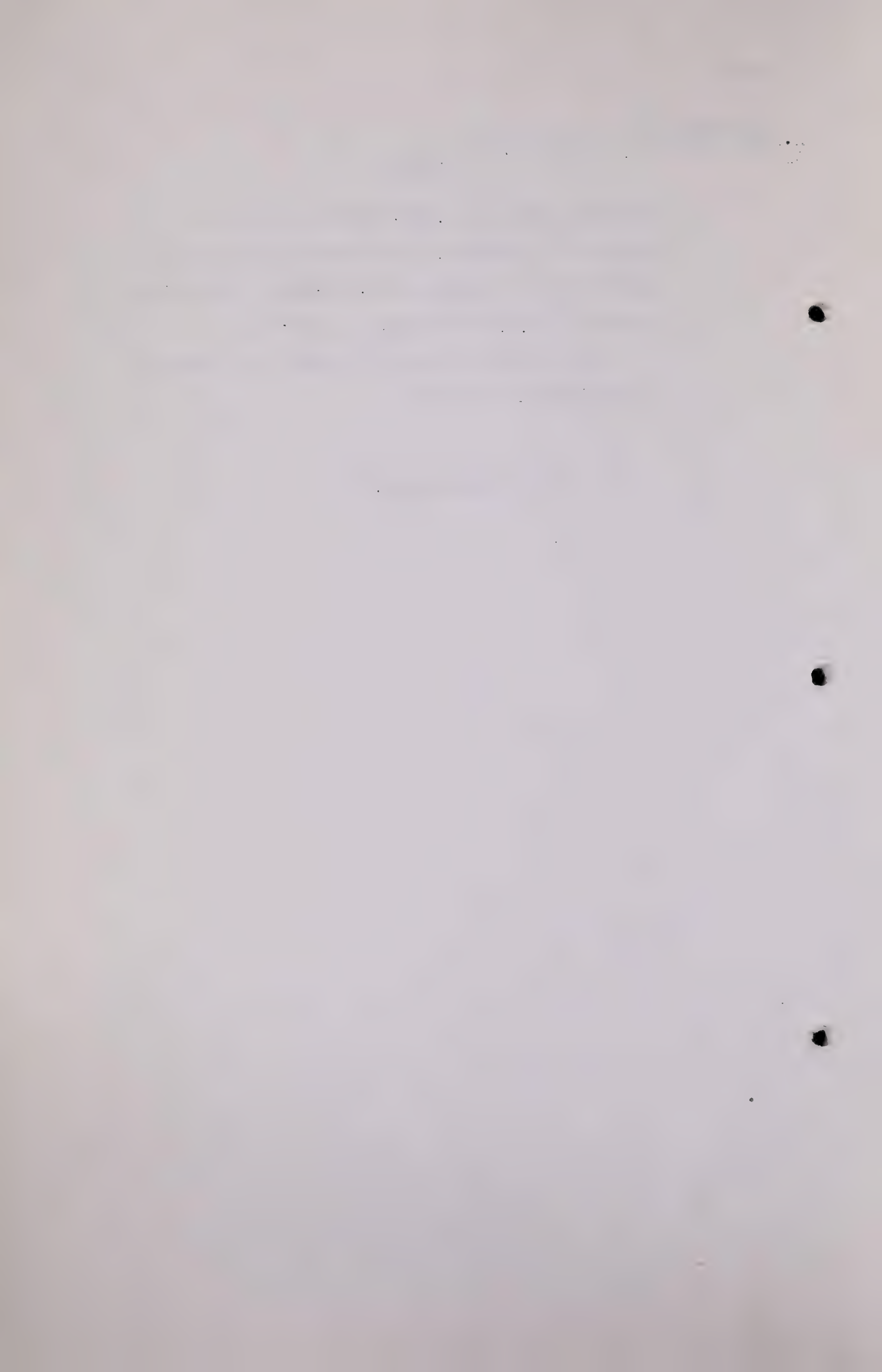


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"claims an amount of \$20,000.00 to provide an inventory of parts of 6,600 and to cover 60 days' expenses at an estimate of \$81,521.00 per annum, as set out in B.A. Volume 2, page 41.

Our recommendation is \$15,000.00 as computed in Statement W-H-24."

(Go to page 4610.).



T-2-1 10.45 A.M.

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Cross-Exam: by Mr. Chambers.

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Q THE CHAIRMAN: Any cross-examination?

CROSS-EXAMINATION OF THE SAME WITNESS BY MR. CHAMBERS.

Q Mr. Hamilton, as regards this question of salvage, and I am not referring now particularly to the B.A. or Madison, but I am referring in relation to equipment generally in the Turner Valley field. I suggest to you this, that if salvage is allowed for or deducted now in computing depreciation, that at the end of the operation would you then agree that the equipment, such as it is, good, bad or indifferent, then could be disposed of by the utility company as it sees fit. Would you agree with that proposal?

A You are speaking of Madison at the moment?

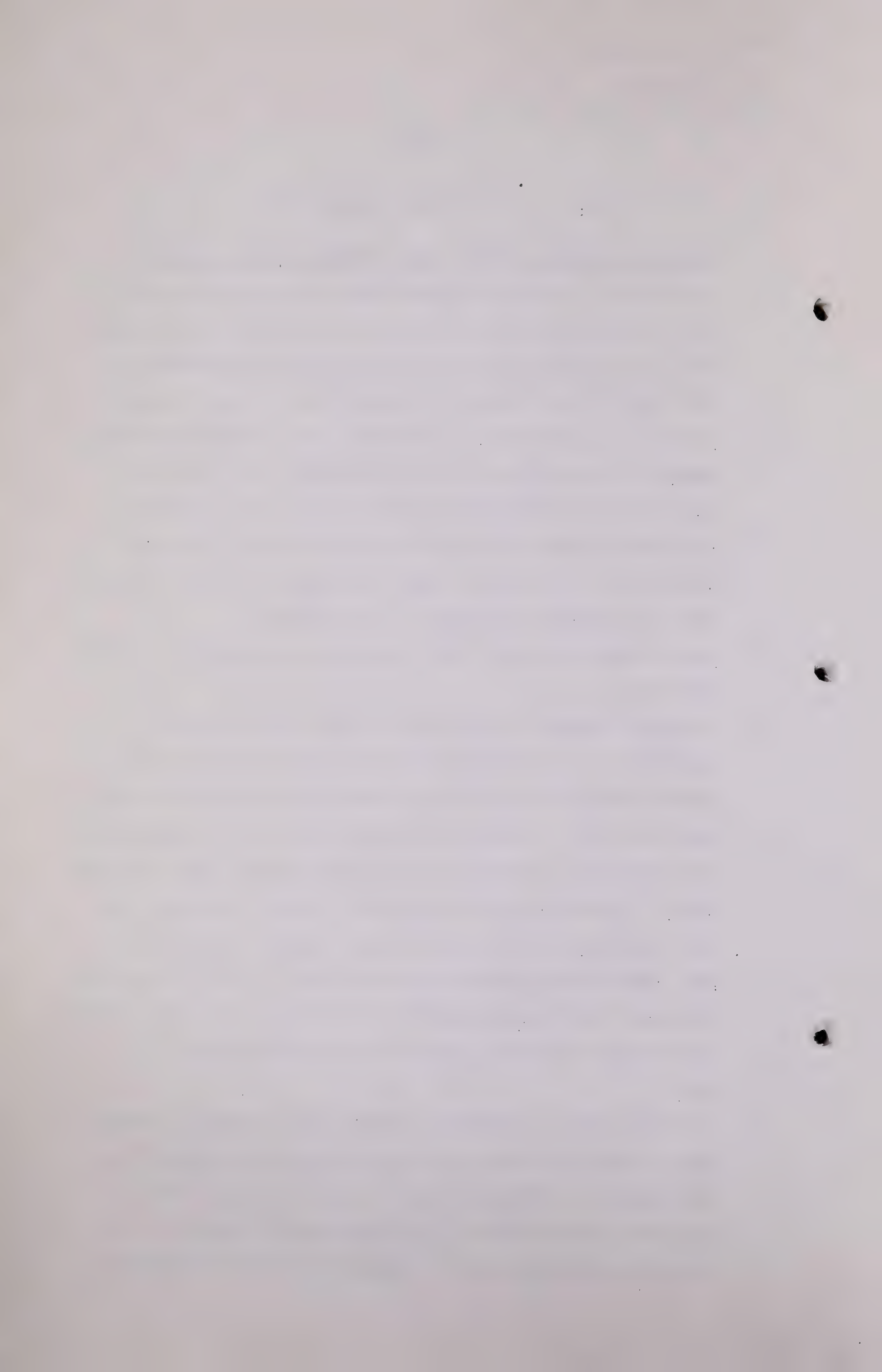
Q Any of these companies that are now being regulated in the South end.

A I think it makes a difference whether the assets are committed to an enterprise for the life of the field or whether there is any imputed underwriting on a restricted basis of life. Because the Madison assets, if depreciation is calculated on the basis of assumed salvage value of X per cent, I believe it would be proper for the Board to, from time to time, review that estimated salvage percentage in the light of developing conditions with a view to ensuring that the final percentage obtained is that that will closest approximate the actual salvage which will result.

Q Yes.

A In other words, I think the public must underwrite salvage.

Q What I really am trying to get at is another phase of the situation. No matter whether the rate is 1 per cent, 5 per cent or 3 per cent, I am suggesting to you that in principle, when you allow a salvage rate for the purpose



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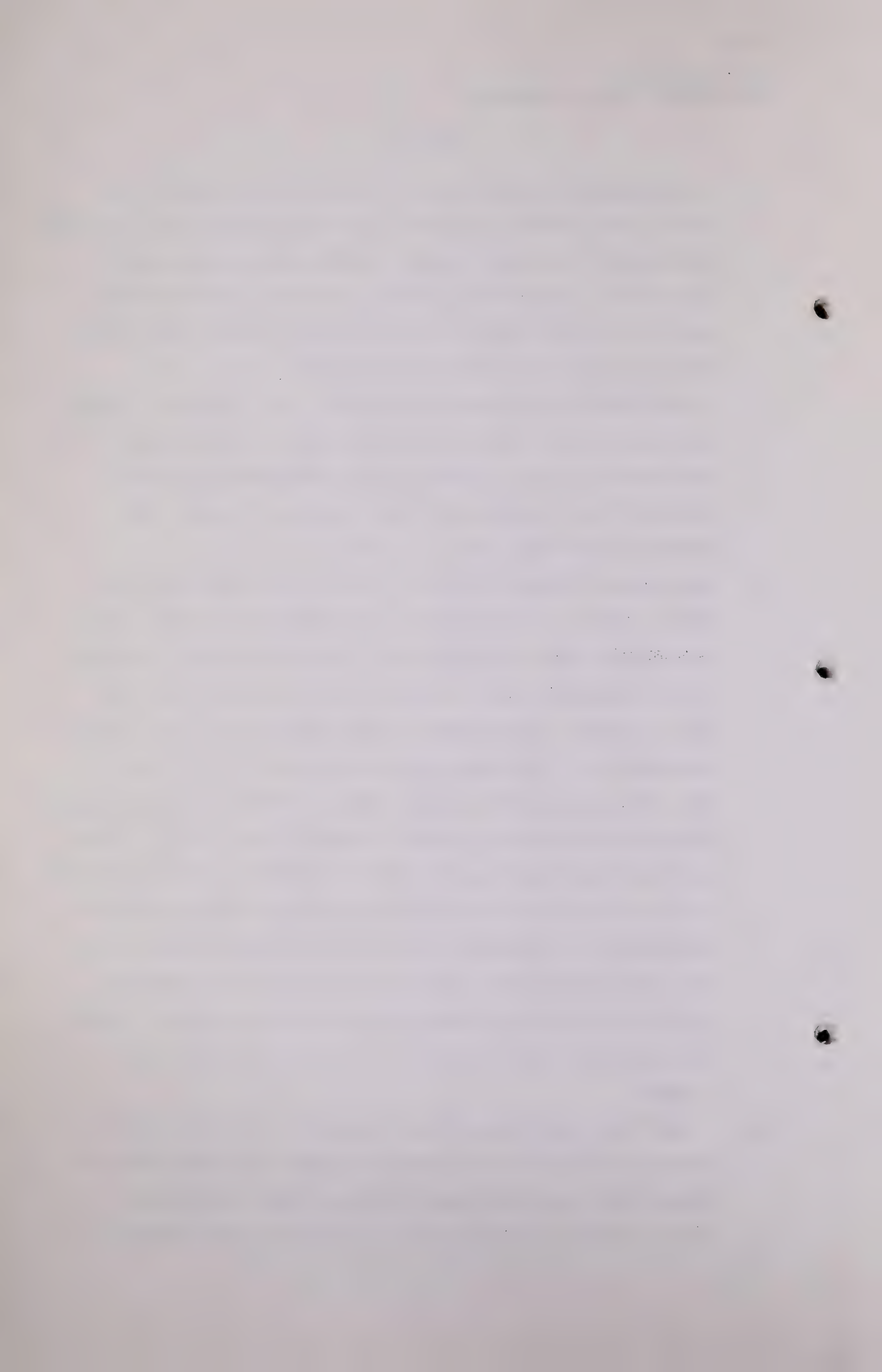
- 4611 -

of computing and providing for depreciation, that at the end of the operation, that is when the equipment has performed the service for which it was intended, that is taking all the gas out of the field, that at the end of that period whatever is left belongs to and should be dealt with by the utility company in any way it sees fit.

A I think that would necessarily follow, Mr. Chambers, because there is no one else in the picture then. The consumer has ceased to be a consumer by your assumption that the field is over. There is no gas moving any place. The company must be the only one left.

Q Assuming that that principle is sound, take the B.A. situation and all the gas has been transported that has to be transported from the South end; and assume for the purposes of our discussion that in the meantime, sometime over the next 10 years, the gas area in the North end is considerably enlarged and a situation might develop that at the end of this 10 year period the Board might consider it good business to extend the Madison system or somebody else build a system up in the North end and tie into the Madison; I am suggesting to you in principle that the B.A. equipment might very well be exported to Montana or sold by them anywhere, whereas in the concept of public interest it might be good business to have that equipment transferred and still kept in public service in the North end of the field. Do you see what I mean?

A I have felt right along that a suggestion of that nature, which must be met, in my humble judgment, now, with respect to what will happen to some of those South end assets. I think it has a bearing on rate of return and the method of



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depreciation and everything else.

Q I am suggesting the same situation might arise in the Madison, in another way; that the operation now set up would be fully performed and the equipment be fully depreciated, less the salvage, and that that property then, in principle as you have said, could be taken anywhere and disposed of at any price by the utility company. Whereas another situation might arise where, we will say, Jumping Pound, that equipment might be used in the public service in that area. In other words what I am getting at is this question of salvage now, as to whether you put it in or leave it out for the purposes of computing depreciation involves a serious matter of principle.

A Yes.

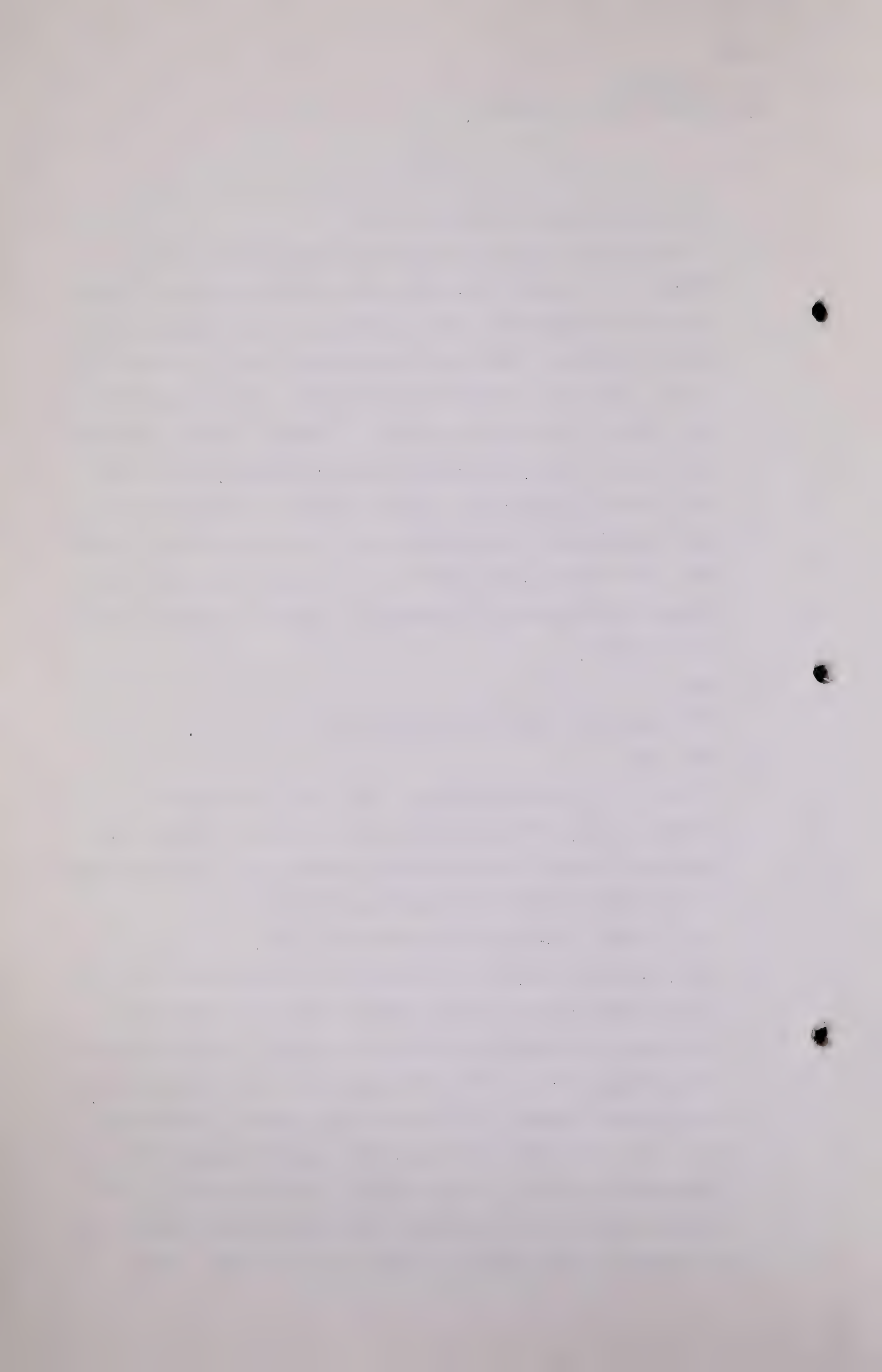
Q That might have real consequences years from now.

A Yes, sir.

Q I want to be frank with you, I have not given any real thought to it, whether it will make a dollar's difference this way or that for the utility company, but I am suggesting it is a matter that the Board should consider.

A Yes, I think particularly in the South end.

Q And I suggest this, for the purposes of discussion, that if no allowance is now made for salvage for the purpose of computing the depreciation and retiring the investment that the principle will operate the opposite - it should operate the opposite because in that event the public, through the rate, have undertaken to retire the entire investment and in principle the public, through rates, would then at the end of the operation be entitled to say whether that should still be devoted to the public service. You see what I mean?



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A I think the principle is fairly sound but the mechanics of accomplishing it would be very difficult if there are no consumers left.

Q What I am getting at is, under this Act as I understand it, all gas in Alberta now is a public utility. I mean the Board can decide whether it is going to regulate this gas or that gas and that all gas is devoted to public service and that the administrative Board under this Act can say now that gas is to be dealt with this way or that way. And I am suggesting if my premise is so and having regard to the uncertainties of the future that it is a question of whether the Board should now decide whether this property is going to be irrevocably devoted to public service and when it performs the operation there, we might want it somewhere else and that that is involved in this question of whether or not you should now take the salvage question into the picture at all, when talking about depreciation.

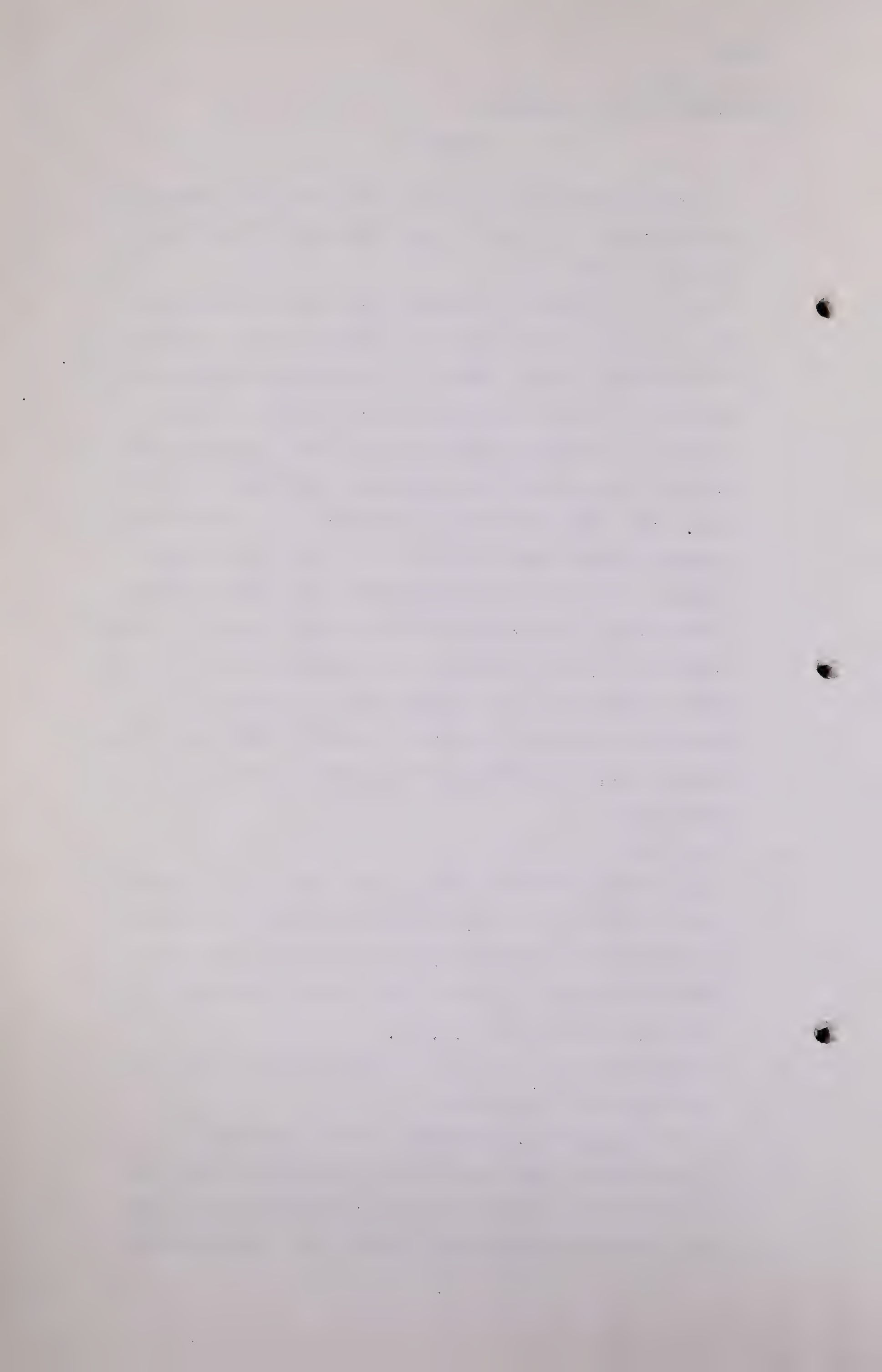
A Yes, sir.

Q Well so much for that. Now on this question of applying the throughput to the B.A. historical cost for the purpose of arriving at a rate base, do I understand that you are recommending that one to the Board or any other particular one which you set forth

A I would recommend a computation equivalent to that which was recommended for Madison.

Q And that involves no inspection of the property?

A It involves an assurance that the property is there and it exists and is in service and will substantially last the field or the particular part of the field with which



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they are associated.

Q You know from the evidence given here, do you not, that a substantial portion of that property had been used elsewhere before it was installed in Turner Valley?

A Yes.

Q And the figure that you use in arriving at your adjusted historical cost would include what figure in respect of those items? How do you get that figure?

A You will recall my statement that I have not examined the books of the British American Oil Company Limited but I am assured that the cost as displayed by these books and the information given to us emanating from that source, that the cost would be the laid-down cost and would be based, I assume, on second-hand prices in the case of materials that came from another location.

Q In other words, the figure you have taken is what the B.A. say they have entered in their books in respect of that?

A That is right.

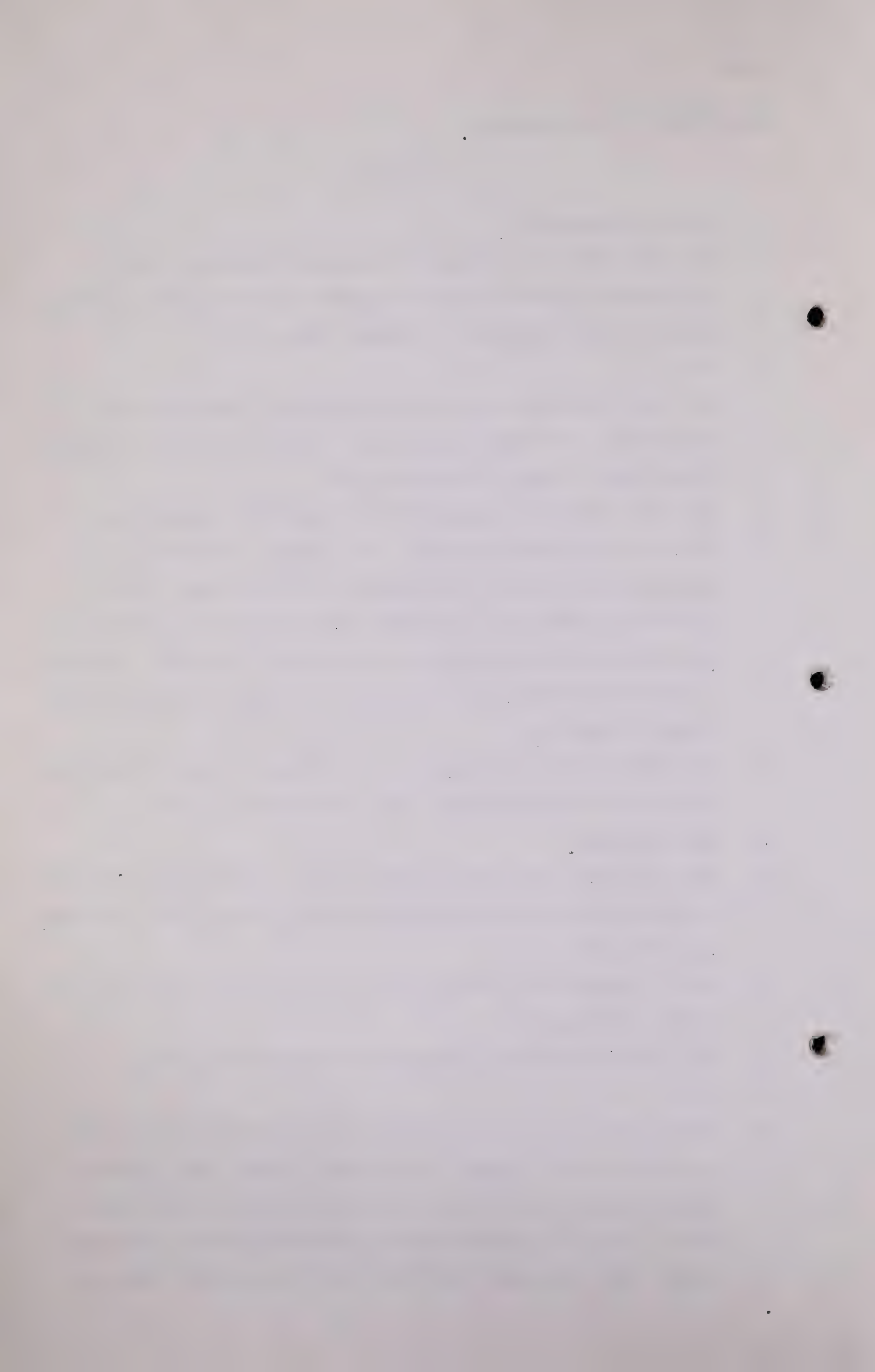
Q And the amount that they entered in their books may or may not have been more or less than the original cost of the item new, is that right?

A It is possible but hardly likely. I am assuming the prudence of the investment.

Q Well let us assume an article was bought in 1931 new.

A Yes.

Q And we will assume that it was used and well maintained for a period of 4 or 5 years and in 1941, we will say, it was no longer needed where it was and it was brought up and put in here. You do not know so far as these figures are concerned whether the B.A. made their 1941 book entry on the basis of



T-2-5

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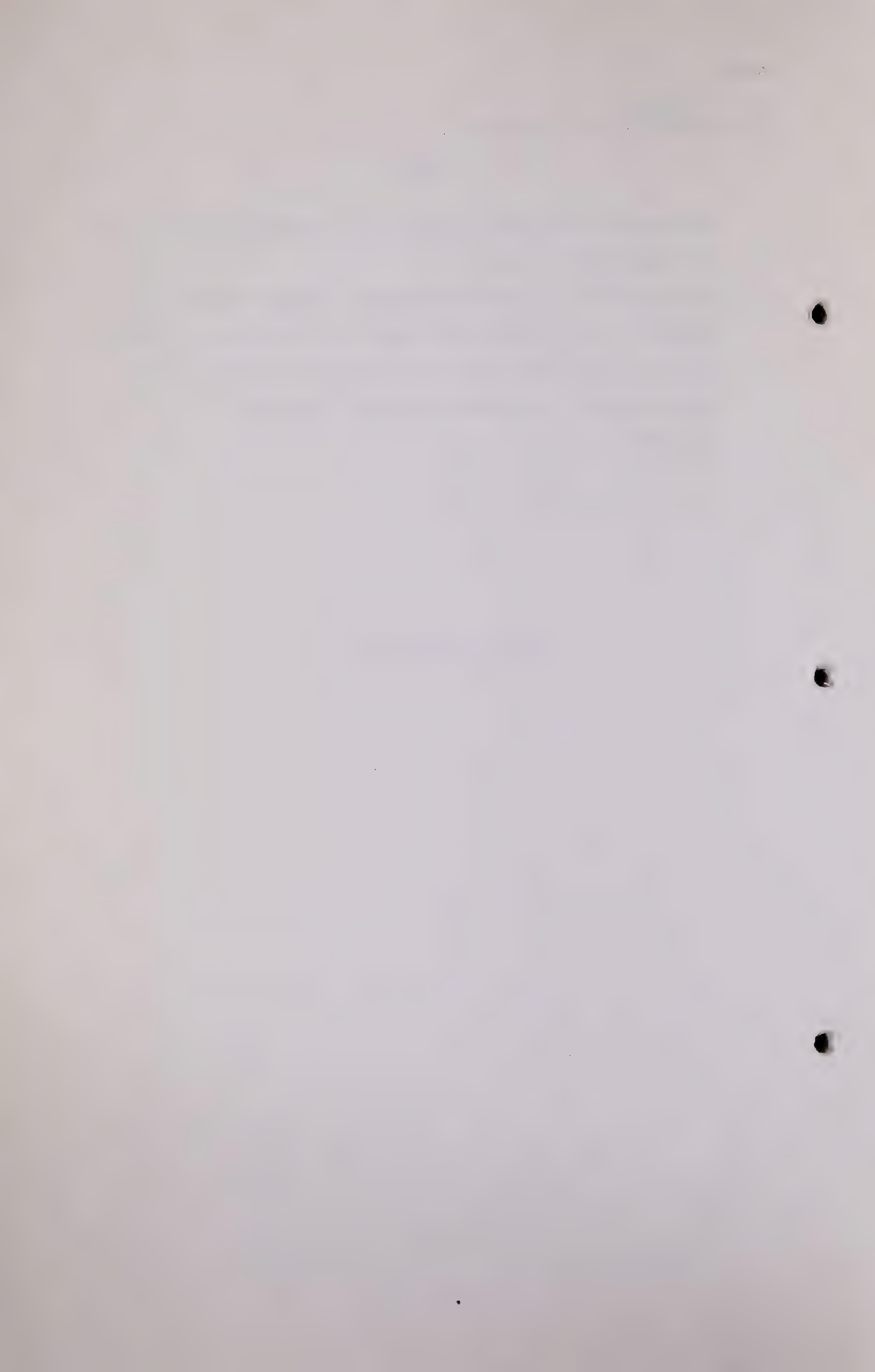
1941 prices new less something for depreciation, do you?

A I do not know, no sir.

Q You know that the British American Company carries on business, either in its own name or through some of its subsidiaries, not only in this country but also in the United States. You have heard that anyway?

A Yes sir.

(Go to page 4616)



C-2-1 11 A.M.

R. W. Hamilton,
Cross-Exam. by Mr. Chambers.
Cross-Exam. by Mr. Steer.

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Q Is it not also possible that this figure on the adjusted historical cost, might depend to a considerable extent on the amount of book depreciation which you have written up against this property, where it was used somewhere else.

A Yes.

MR. CHAMBERS: That is all.

THE CHAIRMAN: Anything, Mr. Steer?

CROSS-EXAMINATION OF THE SAME WITNESS BY MR. STEER.

Q I was not quite clear, in the statement you made, as to the effect that the public must underwrite this out.

A I did not say they must, but in the case which was cited by Mr. Chambers they were underwriting it in effect. As I understand it, Mr. Chambers suggested that one method of dealing with the question of salvage was to ignore it.

Q Oh yes. And in that case the public underwrites it out.

A And if the public is going to pay depreciation charges each year based on a complete amortization then they own the equipment and whatever flows from it at the end. The only thing I cannot see is how you can get that.

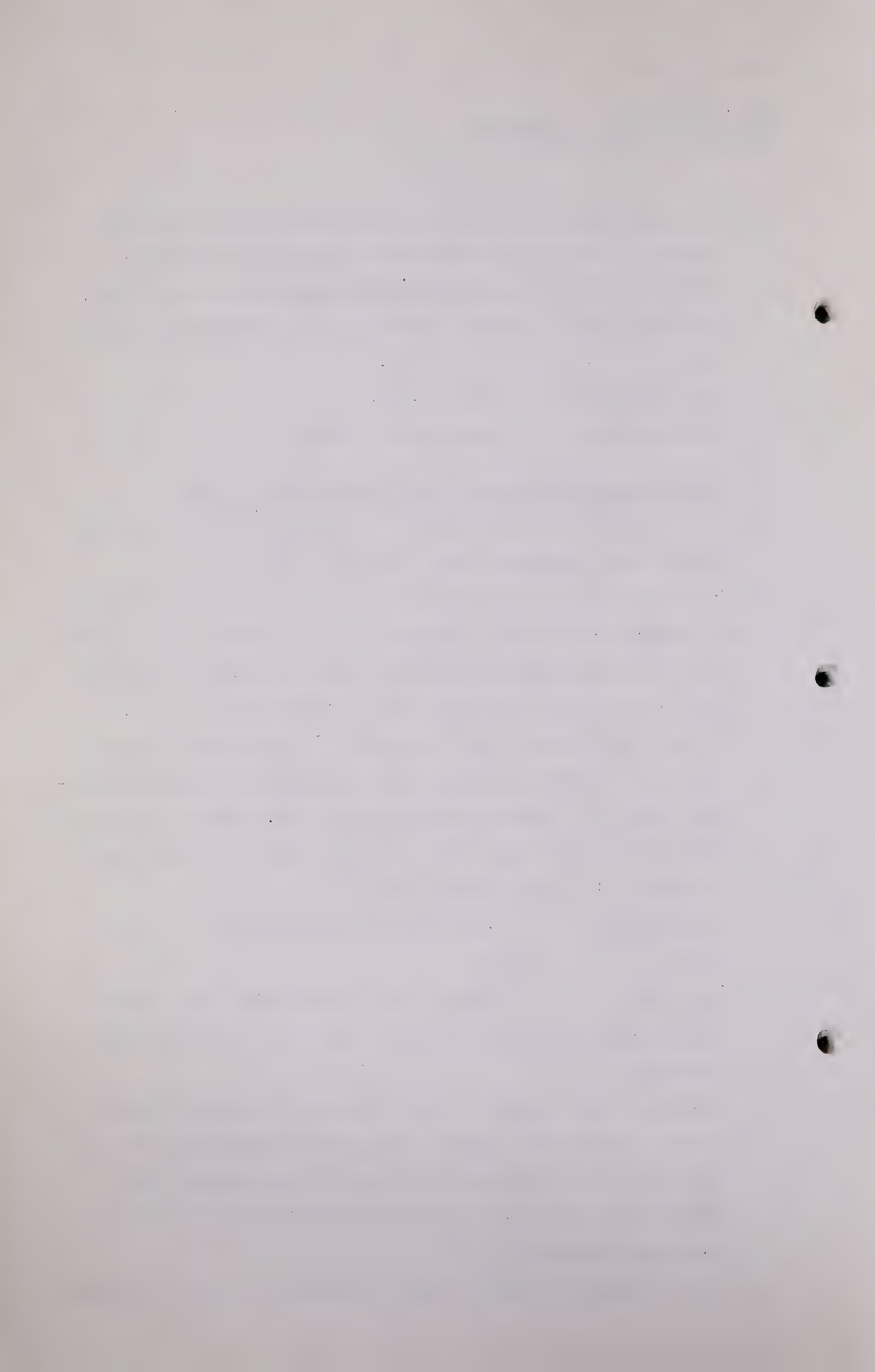
MR. CHAMBERS: I did not intend you should.

WITNESS: No.

Q MR. STEER: You say when the equipment is a public utility and is fully depreciated, then it is owned by the consumers.

A No, sir. What I said was the public was in effect underwriting the complete amortization of the equipment and consequently it might not be unfair to suggest that the public would be entitled to the equipment that it had paid for under regulation .

Q Yes, but what you mean by that, I suppose, is that the public



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would be entitled, if there were any use to which it could be put so as to give service to the public, to have that equipment continue in the public service.

A No, sir, what I meant was this, that if the public does pay rates which are intended to and in fact do completely amortize the investment, if that is the plan, then if there is any salvage it might fairly be said to belong to the people who had paid for it.

Q Have you any knowledge how they could recover it?

A No, sir, that is the practical difficulty which I pointed out a moment ago.

Q Quite so, and from that point of view does it matter whether the salvage is reckoned or not, is it not the position that at the expiration of the life of the asset you are going to have certain capital assets and what disposition is going to be made of those capital assets is going to be a matter for the Board which has control of them, is that not the only way in which they can be dealt with?

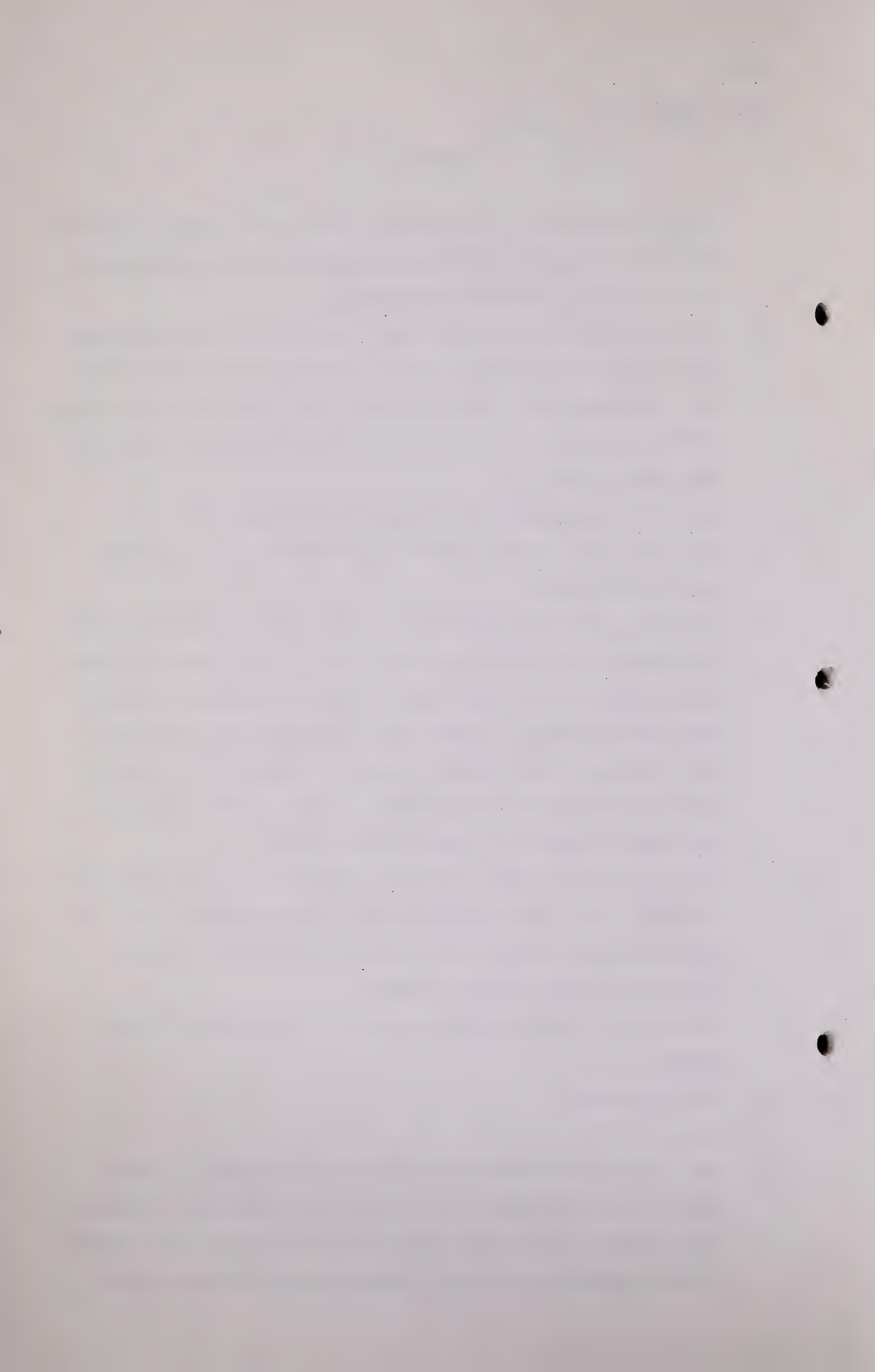
A From a practical point of view it seems to me, as I mentioned a moment ago, when consumers cease to be consumers, the only people who can recover the value of the salvage are the investors in the utility company.

Q But subject surely, subject surely to the control of the Board?

A That is correct.

Q Yes.

A And I was going to say, to follow on from that, it seems to me from a practical point of view that when any presently anticipated use for that equipment had expired, the investor in the company is, in fact, going to realize such salvage



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as there may be, large or small, and consequently it would seem proper at some stage for the Board to anticipate that occurring and that they will, if you are going to get the salvage, then you should not get the amortization of that part of the value of the original cost.

Q Quite so.

A At some stage, not necessarily now.

Q And my friend Mr. Chambers was talking to you about the possibility of the equipment in the South end of the field possibly being required in the North end of the field for service.

A Yes.

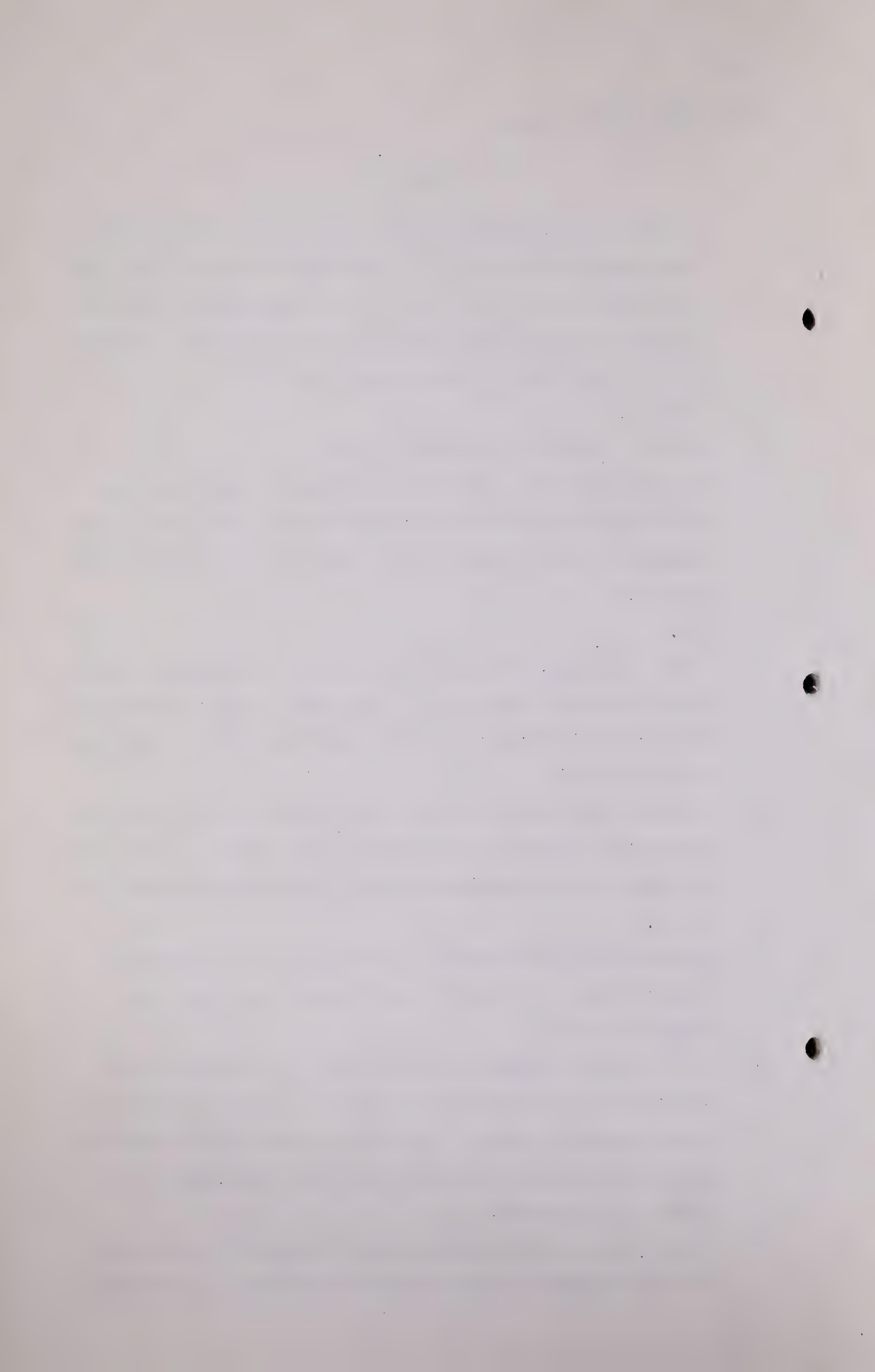
Q That, I suppose, whether that could be accomplished or not, must surely be a question of law under the Act, under which the Board which has control is operating, do you think that would be right?

A I certainly agree that there is a lot more to it than the accounting principles of depreciation. There is the legal feature and the practicability of moving the equipment and so on.

Q And if that is the result I fail to see the bearing of that question on whether or not salvage is taken into consideration.

A Well I think whether or not salvage is to be taken into consideration depends upon either the present determination or the present appreciation of the future determination of what does happen to the proceeds of the salvage in that South end equipment.

Q Would this be the position, that if salvage is considered in figuring depreciation as to the equipment in that field,



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then what happens to that salvage, which we will say represents the real value of the equipment, at the termination of the life of the field, what happens to that salvage then rests on the determination of the Board that has control.

A Yes, and I think the Board would likely take into account that the company still had invested in that equipment unamortized the percentage which the Board worked out.

Q And if the Board took control and assumed it had the legal power to do it, and said to the owner "you are to use that equipment in another area", then in deciding the incidental questions involved in that Order, the Board would certainly consider that they had not been, that the salvage had not been ample.

A That is right, sir.

Q I take it that you do not know the source from which this second-hand equipment of the British American Company came.

A I am not fully familiar with it, I know some of the equipment that went into the 1944-45 installations came from Coutts.

Q Yes, and that was a B.A. undertaking at Coutts?

A That is right, sir.

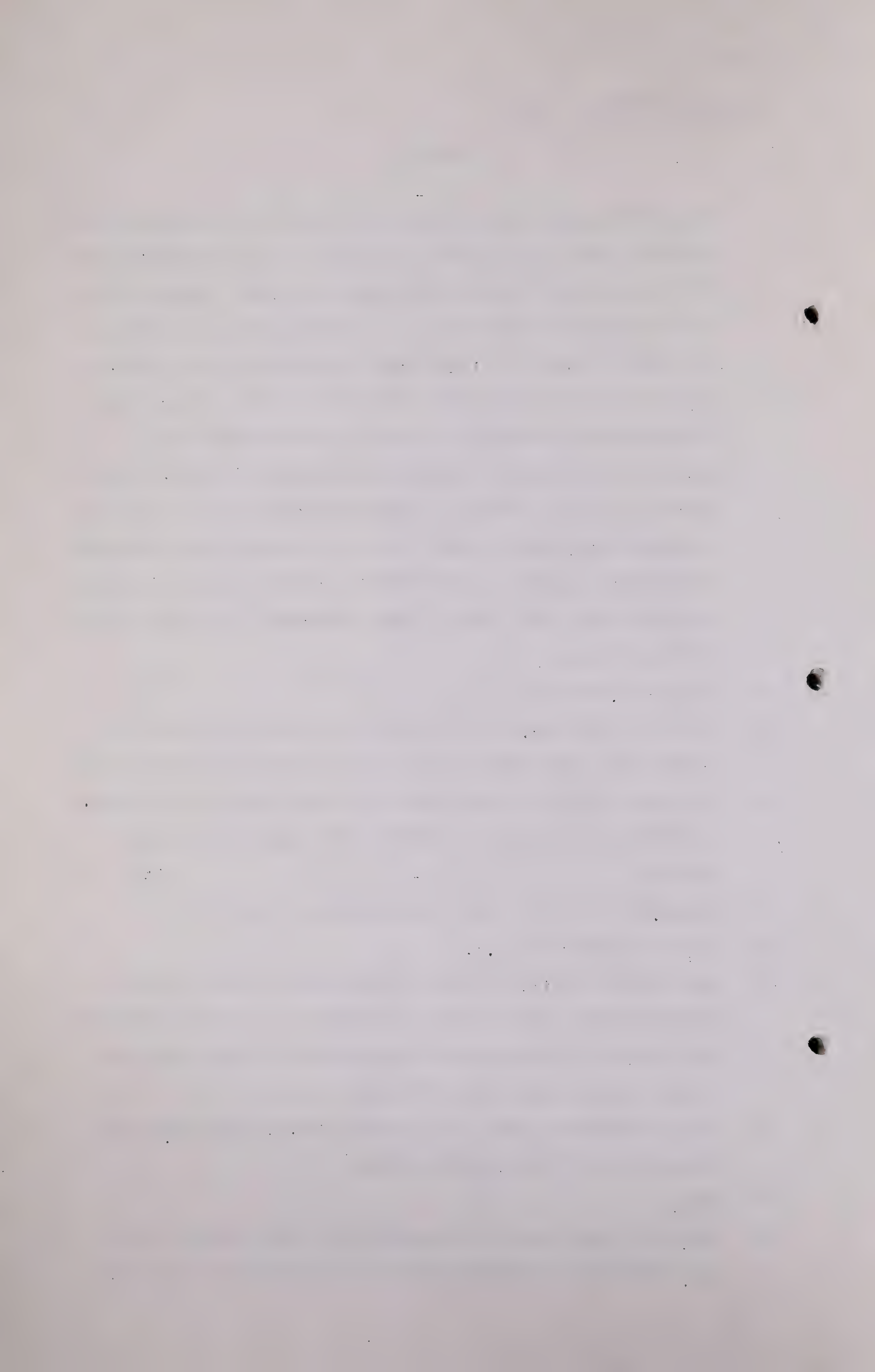
Q But we would have to have an examination of the books to determine how much of that second-hand equipment was bought by B.A. on the open market and whether it came from B.A. itself or associates or affiliates of B.A.

A You are speaking now, sir, of the installations prior to 1944, the old high pressure lines?

Q Yes.

A Yes, you would need an inspection of the books for that.

Q And that is information which we ought to have if we are



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going to have a check on historical costs at all.

A Well there are two possibilities, one is to assume the propriety of the figures you have or to make an inspection of the whole system of accounts of the British American Oil Company for a great many years back, with a view to the determination of that proposition.

Q We would not need to go back beyond 1936 because the plant originated then, as I understand it.

A But you might have to follow those particular assets which had been transferred from some other place back to the original location. It could be done all right.

Q Would that be so if you had a purchase in the open market from a stranger, of second-hand material?

A No, sir.

Q You could rely on that figure?

A Yes.

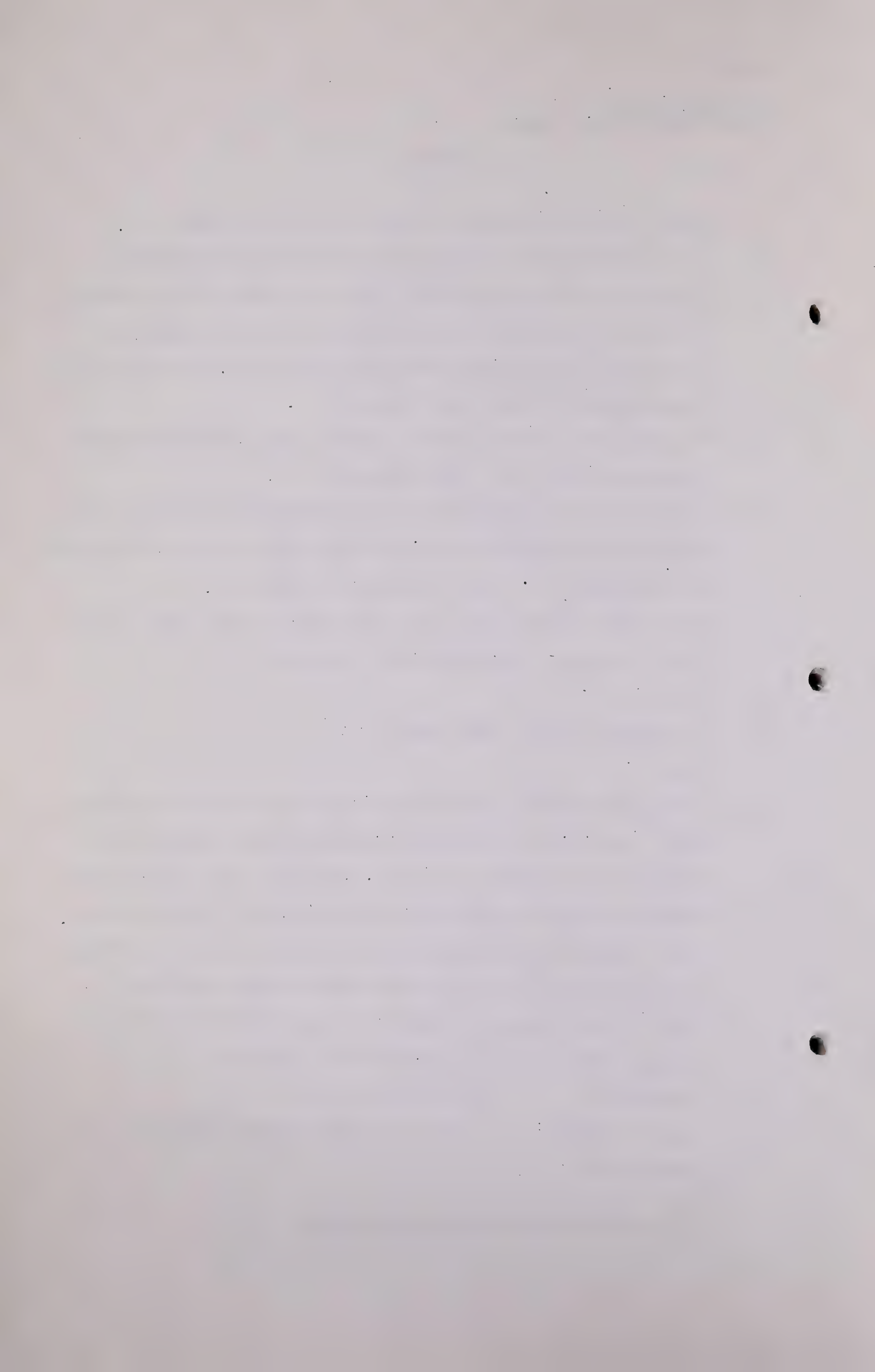
Q But as far as the assets which were got from other places where B.A. was operating or were got from associated or affiliated companies with B.A., then the kind of question that you suggest would have to be asked and followed up.

A Yes. We did give consideration to making such an investigation but the amount involved over-all did not seem to warrant the expense to which the Board would be put to conduct such an inquiry, that is at present.

MR. STEER: Yes, that is all.

THE CHAIRMAN: I think we will adjourn now for a short time.

(A short adjournment was here taken.)



R. W. Hamilton,
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CROSS-EXAMINATION OF THE SAME WITNESS BY MR. FENERTY, Continued.

Q Mr. Hamilton, in statement WH 18 dealing with the high pressure gathering line and water system, and I am referring to the second column, the 10 per cent general overhead, in each case the high pressure and the water system, do you know whether or not any amount for overhead has already been included in these figures of historical cost, do you know anything about these details?

A I am informed not.

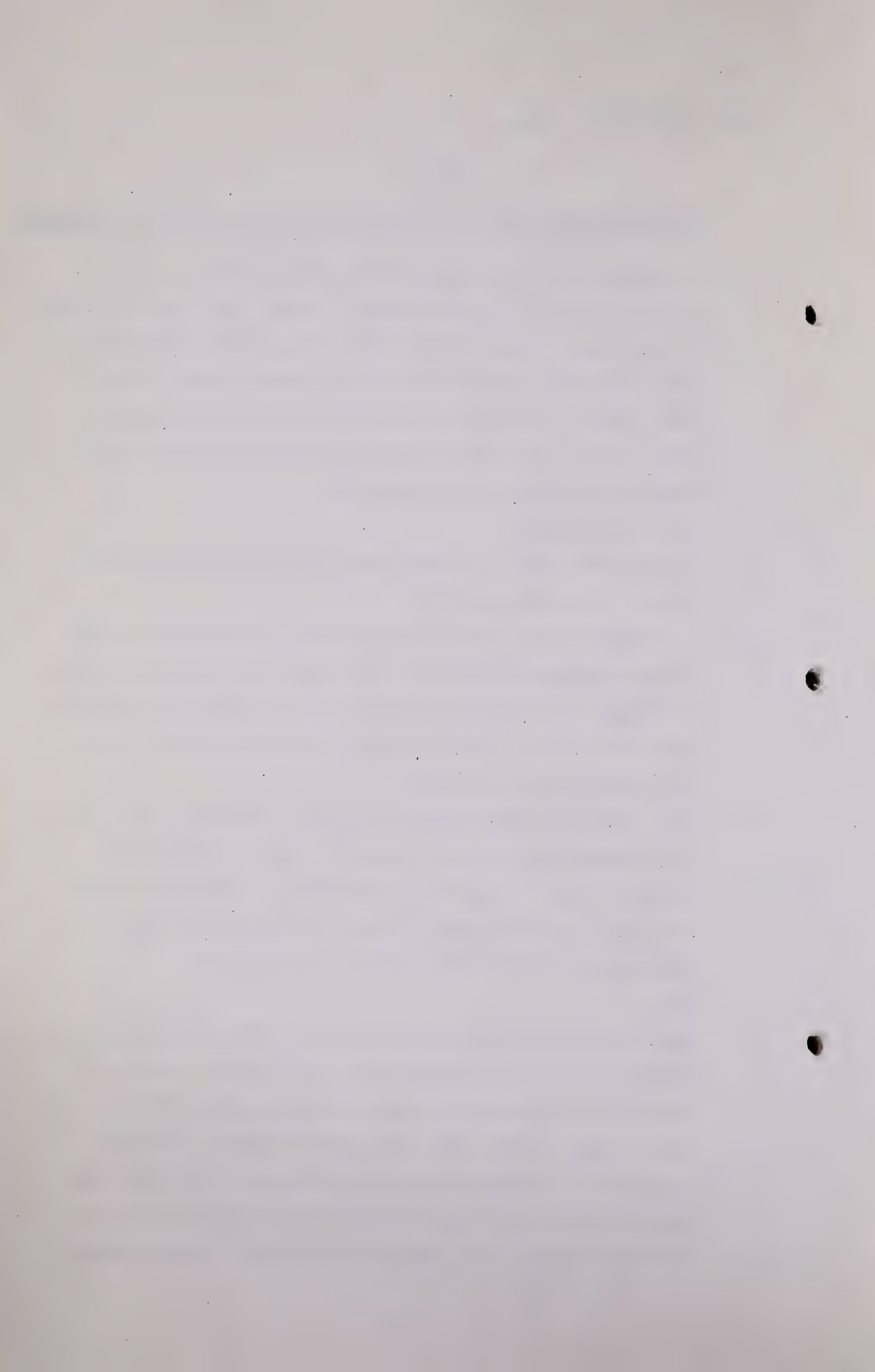
Q You have not made a personal examination but your information is that they are not?

A My information is that the historical cost represents the direct expenditure and the 10 per cent covers the same sort of things which would be included by Mr. Hill in connection with the Madison, his 9 per cent plus construction, tools and transportation charges.

Q Yes. Now one point brought out by Mr. Chambers, and I think perhaps this is a reasonable time to consider it, a proper time, - there was a reference to the depreciation on equipment which might be used in another field and reference was made to the Jumping Pound field.

A Yes.

Q And reference was made to the effect of the Act as making all gas in the Province devoted to the public service; I want you to assume for a moment that the proprietors of gas in other fields, which we will say may be properly pertinent to Calgary or adjoining Calgary, have under the present Act the same right to participate as we will say the well owners in the South West corner of Turner Valley



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that had not previously been on the line before this legislation, just assume that is the position.

A Yes.

Q I want to ask you what the situation is if we endeavour to work out a market sharing position between these other fields and Turner Valley in other respects than merely in connection with depreciation, you see, to the equipment here; now my idea of the situation is that in the first place you entirely change the yearly amortization rate because you see you have another field of equal size, and if so you reduce the consumption by 50 per cent from Turner Valley, would you not?

A You would change the amount but not the rate, sir.

Q Not the amount but the yearly rate.

A The yearly amount but not the rate.

Q That would be changed completely?

A Yes.

Q Because you, in effect, double the life of the Turner Valley field.

A In terms of years, yes.

Q And then you will also entirely change the cost per mcf of gas?

A Yes.

Q Because your fixed charges will remain with half the amount of gas used.

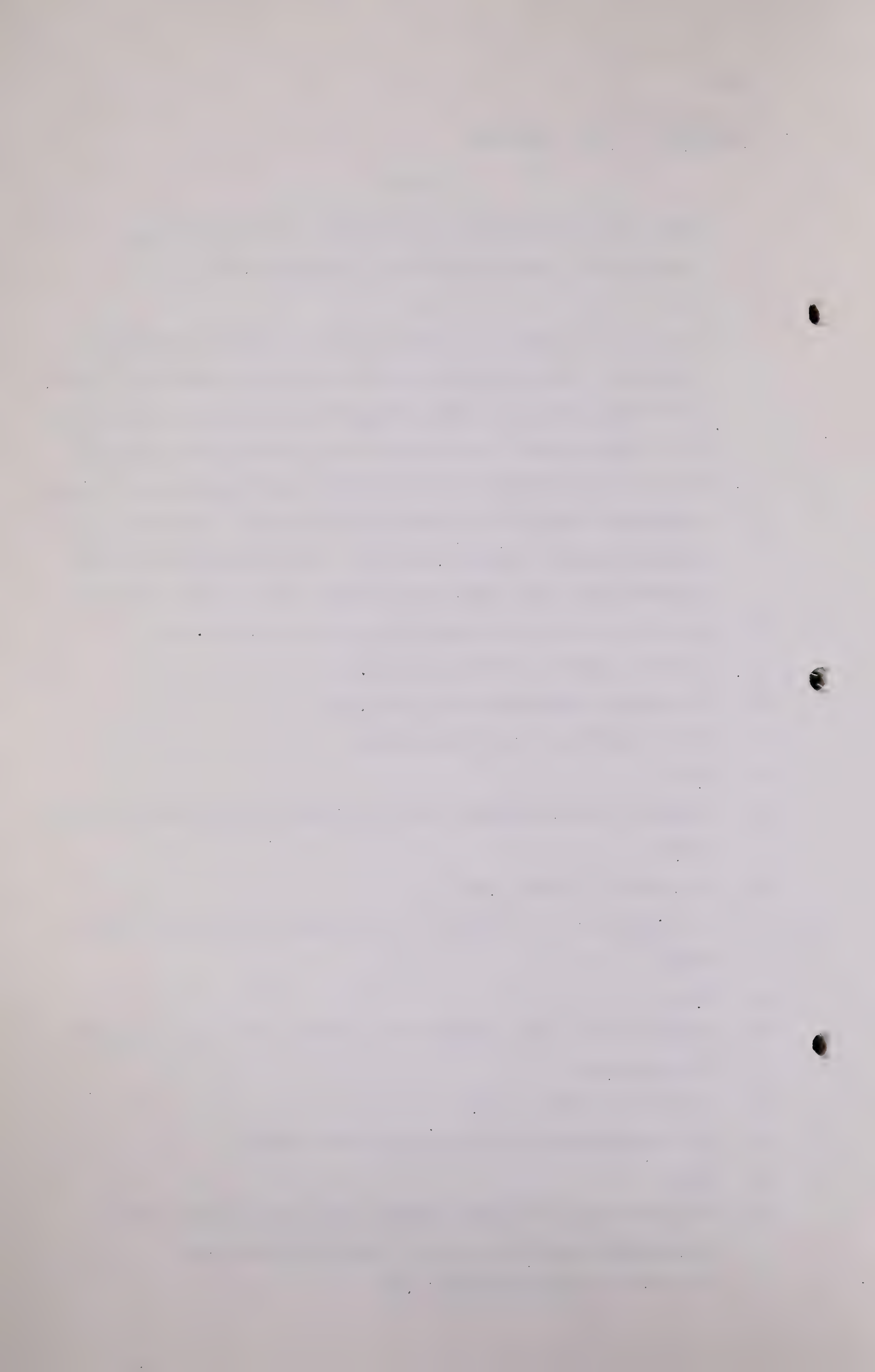
A Something of that order.

Q And consequently you will double the cost.

A Yes.

Q And you will, all other things being equal, double your compression costs if the oil industry continues.

A You would more than double it.



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Q Well double is sufficient for my purpose.

A Yes.

Q You would change them anyhow?

A Yes.

Q So that your idea of the situation is the same as mine, that if a market-sharing position, as between fields, occurs, these figures that we have been discussing for so many months are more or less figures in the air?

A Yes.

MR. FENERTY: Thank you?

THE CHAIRMAN: Mr. McDonald.

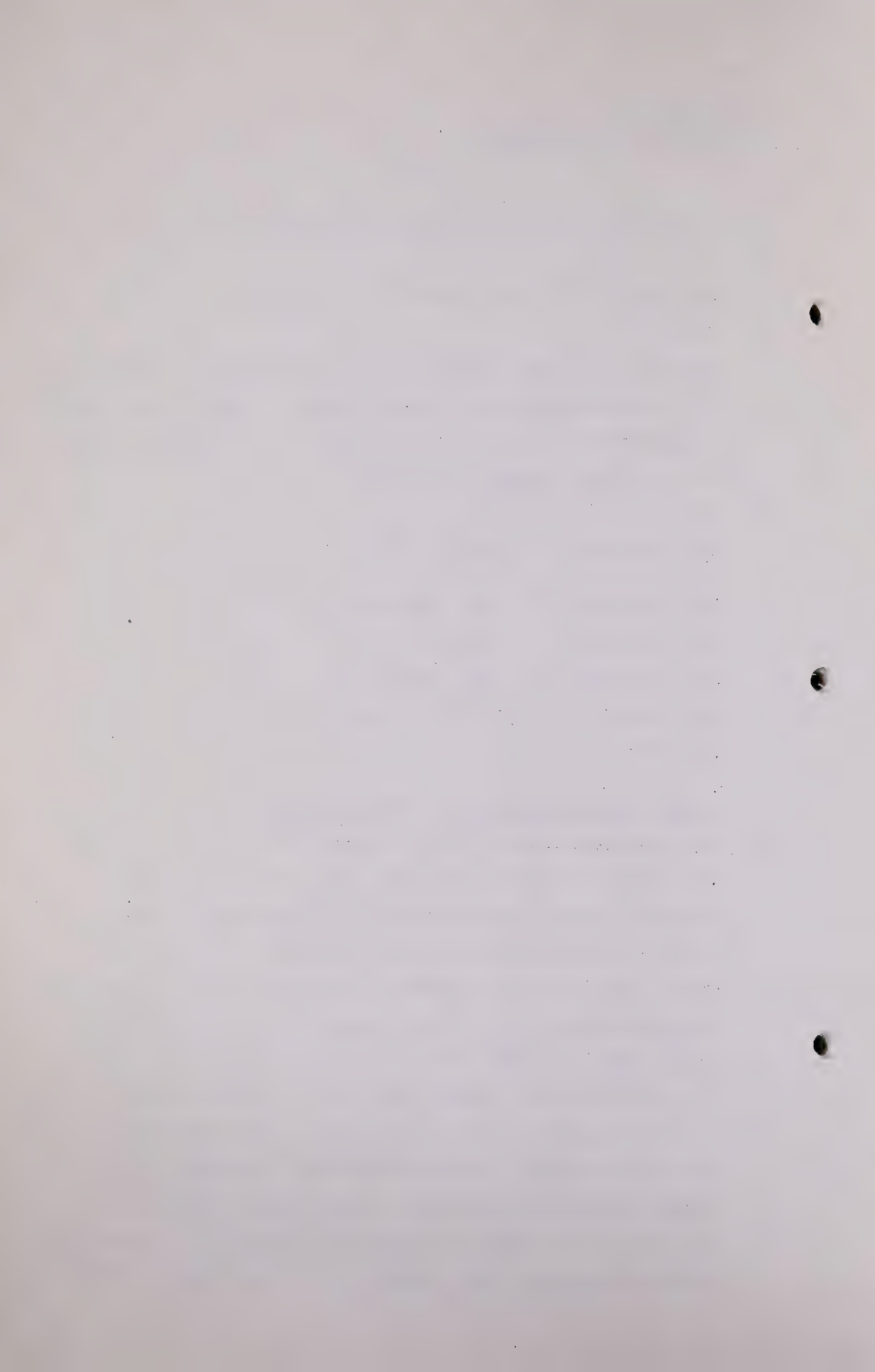
MR. McDONALD: No questions.

THE CHAIRMAN: Mr. Harvie?

MR. HARVIE: I have a question I would like to ask, Mr. Chairman.

CROSS-EXAMINATION BY MR. HARVIE Continued.

Q Mr. Hamilton, I would like to discuss with you for a minute the matter of salvage which you were discussing with Mr. Chambers, as to the advantages and disadvantages that occur on having a salvage value considered at the present time; would you differentiate your approach to that between a case where we will say new equipment was put in and operating today and depreciated on a unit basis from now until the end of the unit period, where there was no question as to the valuation of the new equipment, new costs today, purchased outright, as against the case where you would take old equipment which has a useful life, sufficient to look after the remaining units to go through it, and we will say, depreciated to the extent of 50% on the basis that 50%



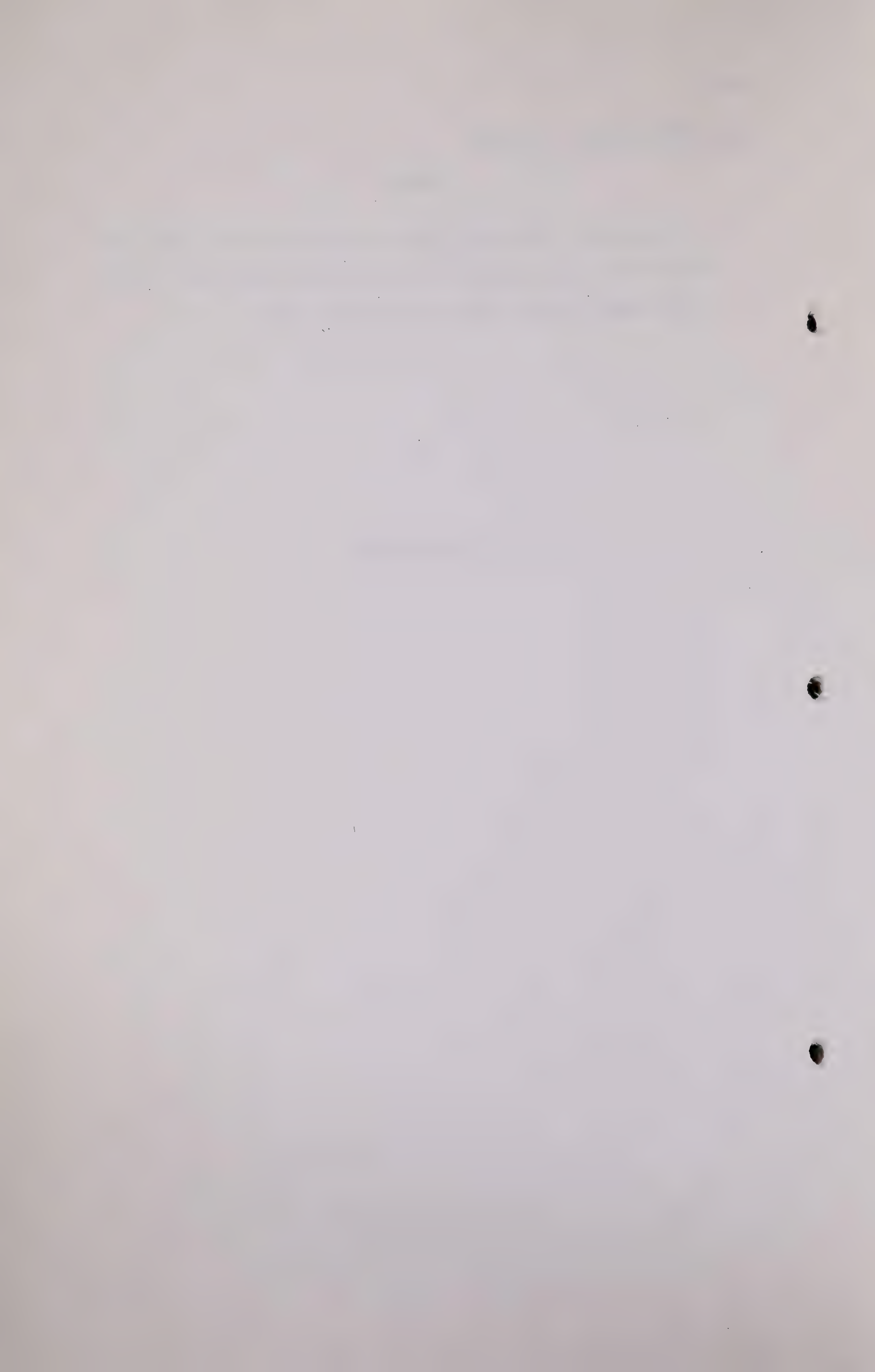
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of the total units that will go through in the past and the future, have gone through, do you think there is any difference in the approach you would take?

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A Certainly the Engineer's opinion as to the percentage of salvage might very well differ in the two cases, but surely from an accounting point of view I do not see any difference in the principle involved.

Q Let me suggest this, that if a piece of equipment was worth \$1,000.00 today in new equipment and we will say that the estimate today were that there would be a thousand units going through from now until its useful life is completed, then the basis of the depreciation of one thousand a unit, it would be fully paid for at the end of the period. That is correct is it ?

A Yes sir.

Q And there would be no question as to the fairness of the original cost as it was the market value as it was today ?

A There would be no question.

Q Now take the old equipment. There is a real problem in finding out what is a fair value today for rate base purposes ?

A Yes.

Q One approach that has been suggested is that you take the useful life and depreciate at a unit throughput basis ?

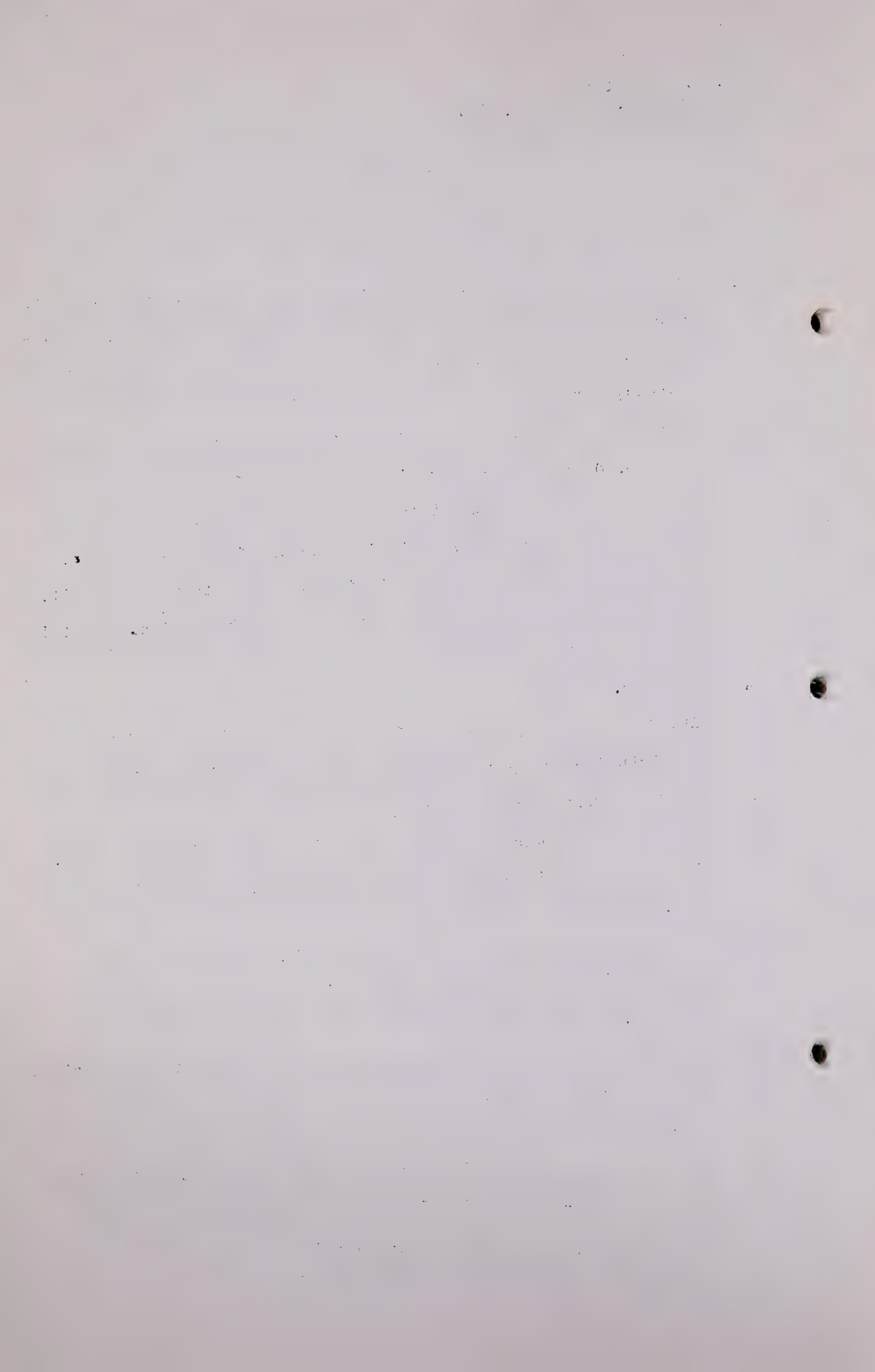
A Yes sir.

Q And taking that same equipment we will say that the historical original cost was \$1,000.00 ?

A Yes.

Q And that 50% of the units have gone through and 50% is still to go through. The valuation that will be given it today using that formula would be \$500.00 ?

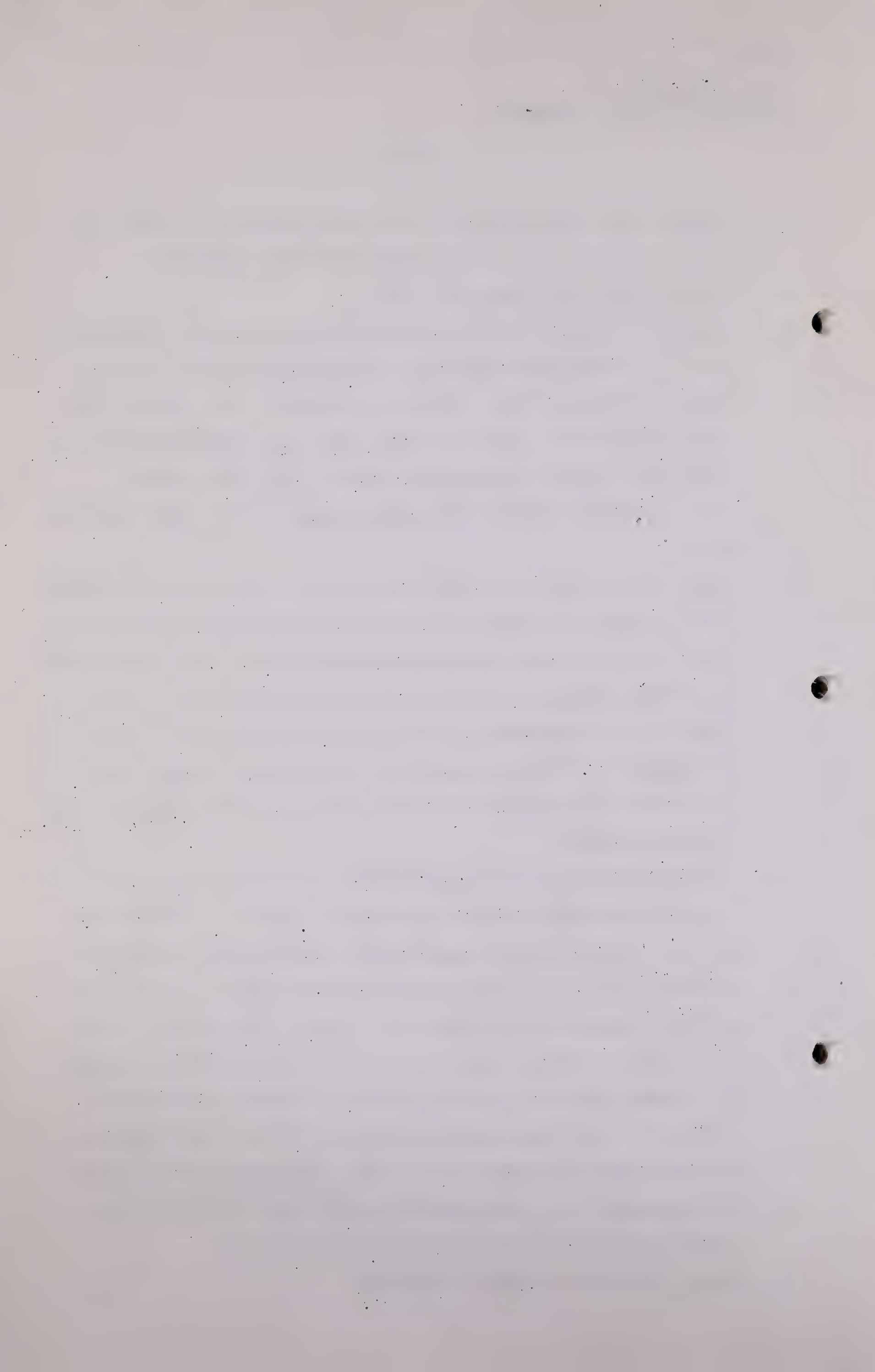
A Yes sir.



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Cross-Exam. by Mr. Harvie.

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- Q Now when the remaining units have gone through the owner of the equipment would have got paid back five hundred ?
- A On the fifty cent rate per unit.
- Q And at that time we will say that there is some new use found for it or additional reserves. It is going to be used for another period of time. Would you suggest that at that time there should be a revaluation for rate base purposes if it is going to be used in the public service after that time ?
- A If it was to be used by the same operator in the same location, no.
- Q Then do you think it is fair to say that just because an engineer's estimate is wrong that there were only five hundred units left at the time the valuation was made, is it fair to say that the Company should be penalized on that basis where in fact it proves that there was, we will say, another thousand units to go through. If the estimate had been another thousand units as at the date of valuation it would only be depreciated one-third instead of 50% ?
- A I think there are two considerations to take into account, and as part of the answer to the question Mr. Harvie. In the first place I think we must recognize the field reserve determined at the time of coming under regulation is assumed to be the best estimate possible and whether the estimate is correct or not the Board in fixing a valuation on the basis of that estimate in a sense makes it partially possible for the operator to escape the risk that would be involved if the field life were shorter than the estimated. In other words so far as possible the consumer in a sense guarantees that the life will be so long expressed in terms of the units estimated.
- Q Just let us see if that is correct.



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A Would you like to examine that part first or should I give the other consideration now. It may affect what you have in mind.

Q We will take that part of it Mr. Hamilton I think and use the figures that we have used. That this unit is valued at \$500.00 today and that five hundred units estimated remaining to go through, which would mean at the end of that period they would have been paid out their \$500.00. Now you suggest you are giving some security to the Utility Company by the Board giving them the assurance that they will get that through. My suggestion to you is that we find there is only three hundred units to go through and the Utility's useful life comes to an end. There is no way the Utility Company gets the remaining 20% or two hundred dollars and I do not think it is any security at all.

A That was the second point I wanted to deal with and it raises this question. There are two possibilities with regard to the foreshortening of the field life. One is a case in which the anticipated future reserve at a particular moment disappears in entirety. The other is a case where the fact that the field life at some previous date had been over estimated is now apparent and consequently the depreciated schedules may be adjusted. Perhaps I could illustrate that by an example. Supposing in the case of the British American we will say, today there are sixty billion feet to go through the system and at the normal rate of withdrawal at the end of 1950 let us say, there should still be at that time remaining twenty billion. Now if another survey is made at that time and the engineers say there is not twenty billion, there is only ten billion. Then it is within the competence of the Board to direct the Utility

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to accelerate its depreciation charge so that the remaining ten billion feet bear the depreciation which on the previous forecast would have been borne by the remaining twenty billion. So that the Company does in fact achieve 100% amortization although it has to be accomplished by an accelerated rate. That presupposes, of course, that the depreciation of the diminution in the field reserve estimate comes soon enough that the change in the depreciation rate will not result in a price which is totally uneconomic. The other situation is one in which at the end of 1950, when we should have twenty billion, we wake up in the morning and find it is not there. Now in that case it is true that the utility does in fact lose the unexpired or unamortized portion of its investment, but I am rather inclined to think from the evidence I have heard that that is not a very likely situation. That the first is more probable. That is that errors in the estimates made by the engineers and geologists and so forth, can be corrected from time to time with the result that we gradually discount the errors in time to accelerate or decelerate the rate of depreciation.

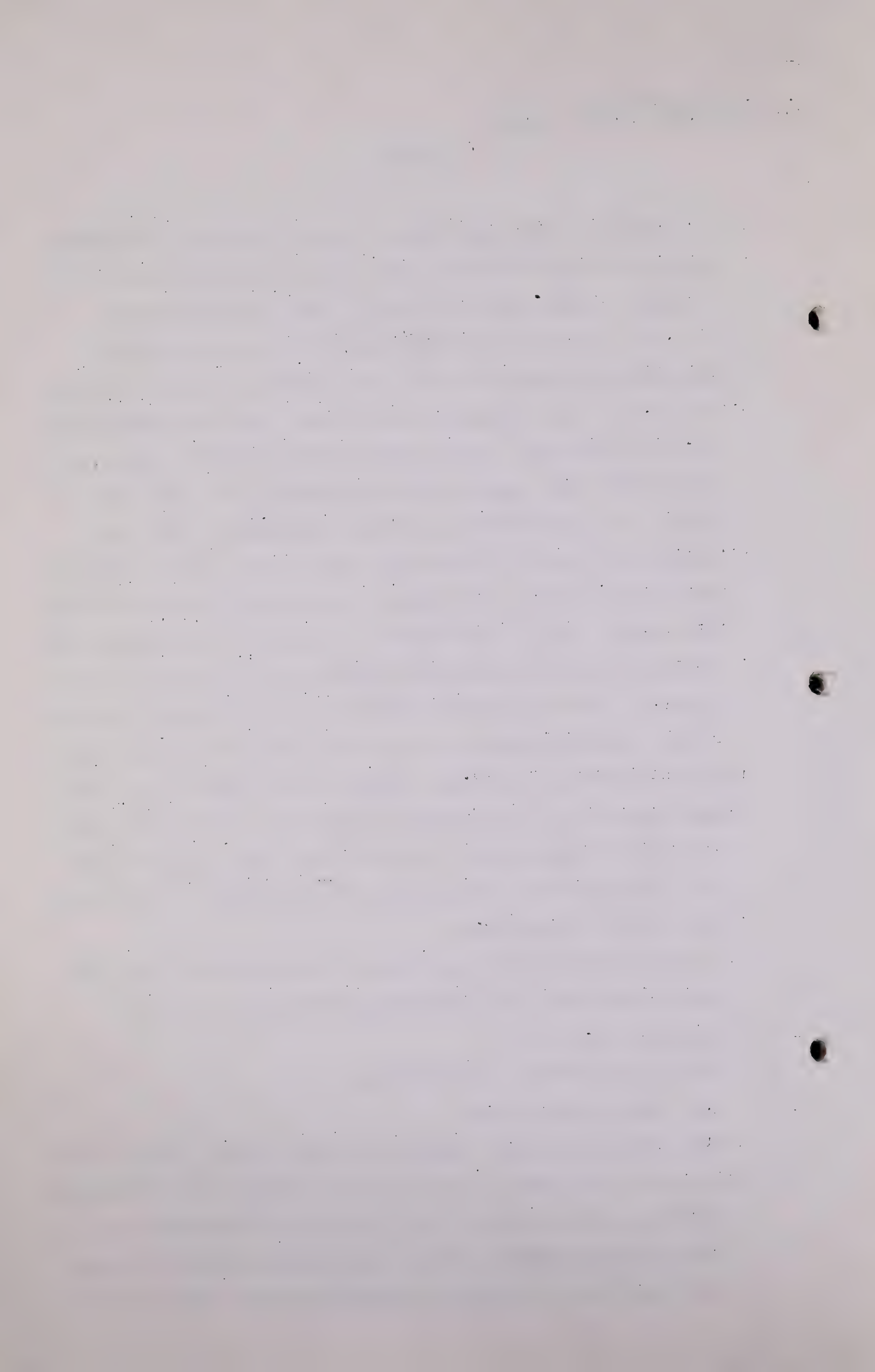
Q If you get that notice sufficiently in advance and that the traffic will bear the remaining portion of the period ?

A Precisely, sir.

Q And that is a risk a utility takes ?

A Yes, that is right, sir.

Q What would you say Mr. Hamilton to this thought. That in the estimates presented to this Board by all Engineers as the future reserves on the basis of their being very conservative and were possibly prepared on that basis anticipating they were to be used for the purpose of justifying expenditures at the



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rather than
present time/for the purpose of use as a unit throughput. I
think, I am going to suggest to you that all the estimates
that have been put in, those that compiled them have indicated
they were conservative estimates and I am going to ask you
that if that being the case, if old assets are depreciated on
a unit throughput basis, doesn't it have that tendency to
give them less value today, when the rate base is being set,
than if the estimates were less conservative or even optimistic.

A I presume that the field estimates are.

Q Conservative ?

A Will result in a smaller estimate than will actually be found
in the field.

Q I think I asked you to assume this that the value given to an
old asset being taken over today and valued for rate base pur-
pose will be less on the basis of a conservative estimate for
the future rather than a liberal or optimistic ?

A That is right. It will have an effect on the rate of return
of course in the opposite direction.

Q You think it should be taken into effect there but I am going
to deal with that later.

A Right.

THE CHAIRMAN: Any further cross-examination ?

RE-CROSS-EXAMINED BY MR. CHAMBERS:

Q MR. CHAMBERS: Mr. Hamilton, I understand on the basis
of the rate base you recommend for both the Madison and the
British American, the principle that is there adopted would
involve this, assuming these two cases. Assume that we have a
pipe line in the south end of the field or in any area of the
field, that cost \$100,000.00, and that the wasting asset or the
gas to be handled by that pipe line on the overall picture

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us we will say one hundred million m.c.f. and on regulation being first instituted it is found that a half, or fifty million has already been put through, leaving fifty million still to be handled. Would you value that pipe line for rate base purposes at \$50,000.00 ?

A Yes sir, ignoring salvage, if we ignore salvage.

Q Now then assume there is another pipe line in another area of the field that costs \$100,000.00, but by reason of its situation that it will handle on the overall picture two hundred million Mcf. of which one hundred million has already gone through, leaving another one hundred million. In that case as I understand it you would include it in the rate base at \$50,000.00 ?

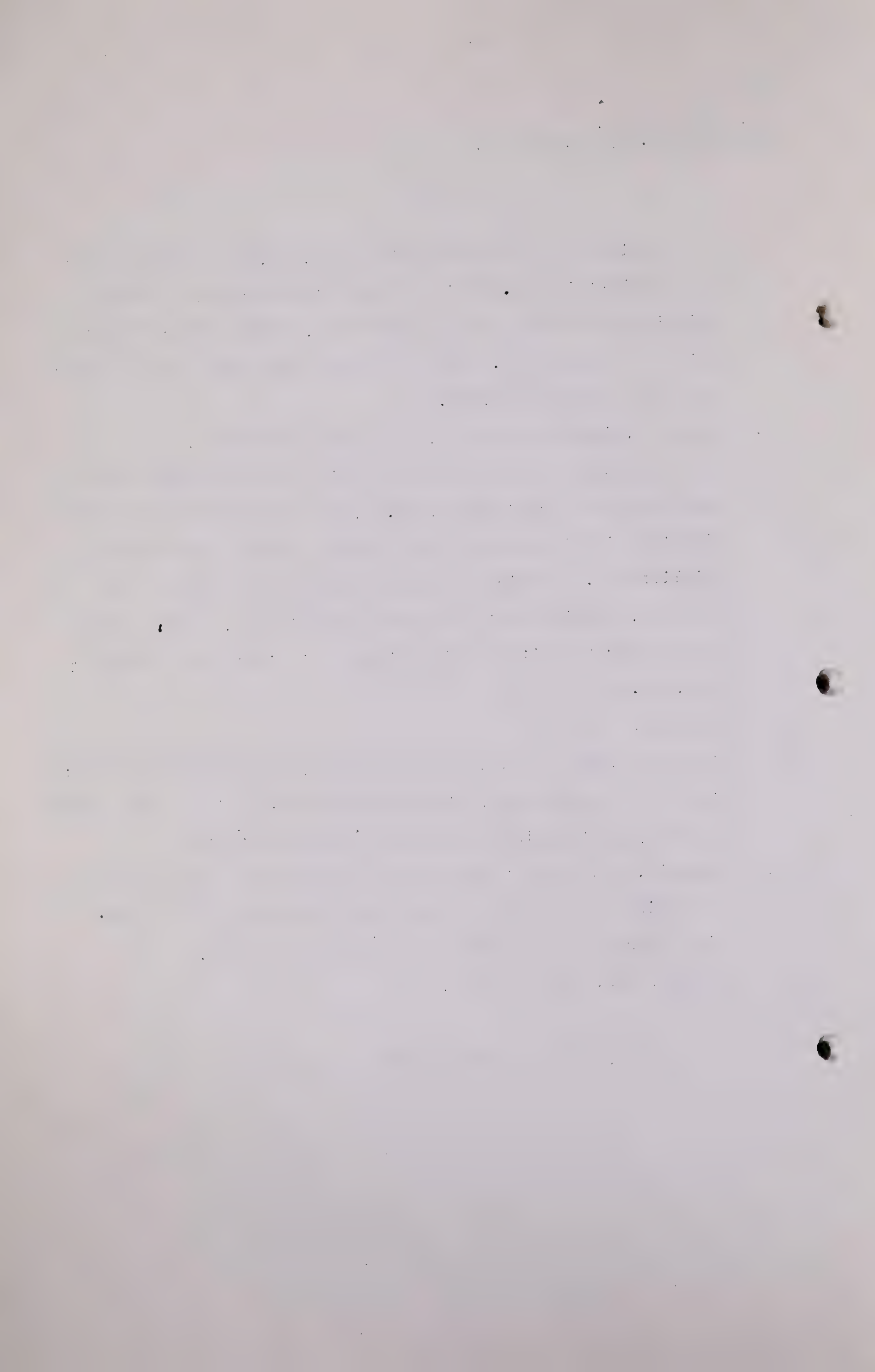
A Yes sir.

Q In other words you would value for rate base purposes the pipe that is to handle only fifty million exactly in the same amount as the pipe that is to handle one hundred million ?

A Yes sir, you are not overlooking the fact that the volume of gas still to be handled is only one criterion of the worthwhileness of the investment at the present time.

Q Thanks, yes. That is all.

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H-3-1 11.50 a.m.

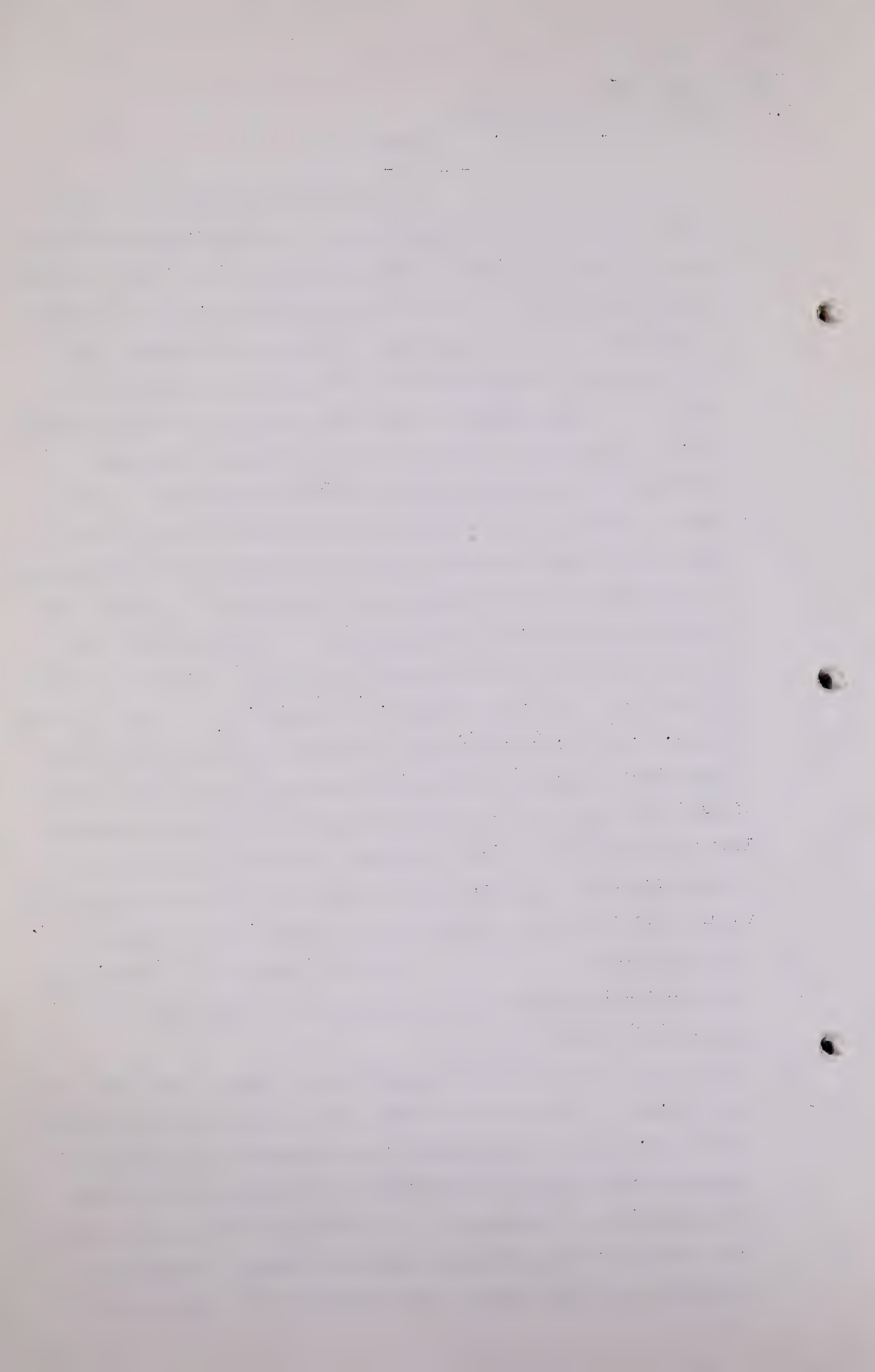
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There is one matter, sir, that I would like to mention arising out of the cross-examination this morning, that might not be otherwise dealt with. Mr. Chambers raised the question of the future treatment of salvage as being a consideration to be taken into account at the present time in determining the rate base and, therefore, the depreciation of it. I think perhaps it might also be said that some consideration should also be given to the question of incidental retirement throughout the life of the two operations. What I have in mind is this, that if we have an asset with a value, a cost of a thousand dollars, and depreciation at rates as directed by the Board of \$200.00, with a net book value of \$800.00, and it is then retired for good and proper reasons, and the disposal value of it, the salvage, is \$100.00, there is a loss of \$700.00. Now, it is important even now to have some idea of whether that \$700.00 is a loss chargeable against current operations in the year of retirement or whether it would be a capital loss which would fall upon the investor in the utility company. The obverse side of it is, of course, whether that retirement resulted in the book gain to be credited to the year's operations, that book gain which accrues to the investor and the company.

Q THE CHAIRMAN: Would the propriety of having made the original investment be the determining factor where the loss should fall?

A It might. I think too it depends on the type of rate base which is adopted. I have in mind this, that if we utilize historical cost less accrued depreciation, the consumer by so doing takes the good with the bad and obsolescence is postponed to be his responsibility. Consequently, the retirement of a piece of equipment because it was obsolete should be, perhaps, against the operation, a charge against the operation to be borne by the



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consumer, and I can see practical difficulties if capital losses are to be borne by the investor. The tendency would be to continue to operate an obsolete plant to get the amortization rather than retire it and sustain a capital loss. I am just thinking of it in regard to its effect on management decisions.

Q Would not that be something which would fall to me to determine at the time of the advance event?

A Perhaps so in individual cases, Sir, but it might at the same time be proper for the Board at this time to give some thought as to how to deal generally with the problem in the absence of a special circumstance.

Q Don't you think I have enough to think about without bringing that one up?

Q MR. CHAMBERS: In other words, I think you subscribe to or think there is something in Professor Stewart's theory of expectations, and that there should be rules or precedents set down so that the people will know under what regulations or under what rules they are operating?

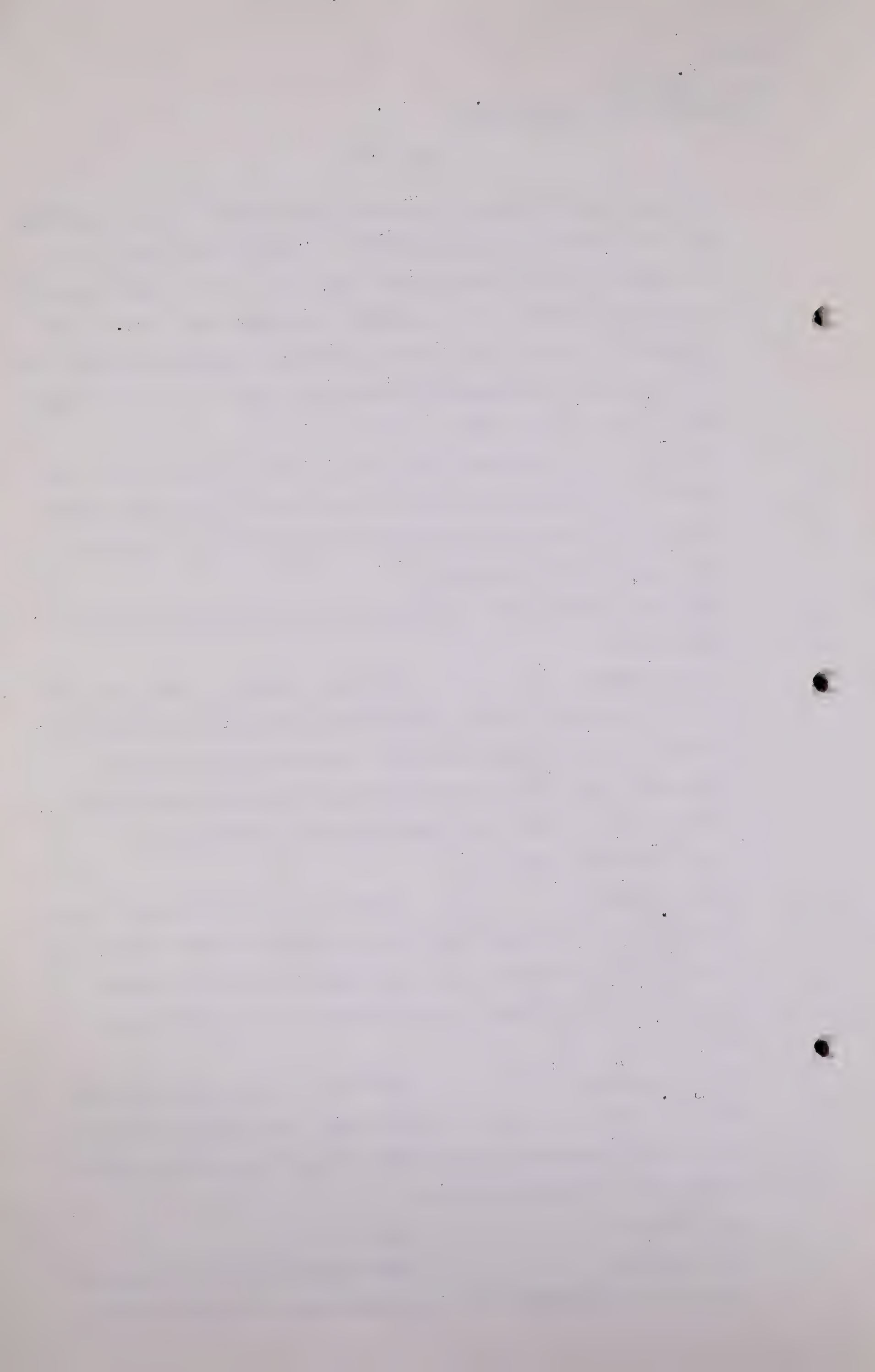
A Yes, similar to that.

THE CHAIRMAN: Haven't you the difficulty there, Mr. Chambers, that I may lay down principles in this particular case and in two years you have another Board and another Chairman and my rulings are not binding on that subsequent Board?

MR CHAMBERS: That is just the point exactly, Sir. We can have rules in theory, but I say regulation as we have it is absolutely an uncertain thing because of the very thing that you mentioned, Sir.

THE CHAIRMAN: Yes.

Q MR. McDONALD: With regard to the problem put to you by Mr. Chambers, Mr. Hamilton, could you deal with the



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pipe line that only handles 50 million against the pipe line of equal size and equal value that handles 100 million cubic feet by apportioning the salvage value to the one that has the lesser use, wouldn't that answer the question, or answer the problem?

A I would think, Mr. McDonald, that the salvage estimates are peculiarly one of engineering appraisal, what you are actually going to get out of the equipment at the time it is retired from service. And the two pipe lines Mr. Chambers spoke about, I assume to be lines that would come out of service at approximately the same time. The one that had the greatest field reserve would be carrying more gas right along than the other and they both come to death at the same time.

Q Yes?

A So that the salvage in the two cases would be practically the same.

Q Would be identical?

A Yes, but one would have a higher salvage value based on original cost.

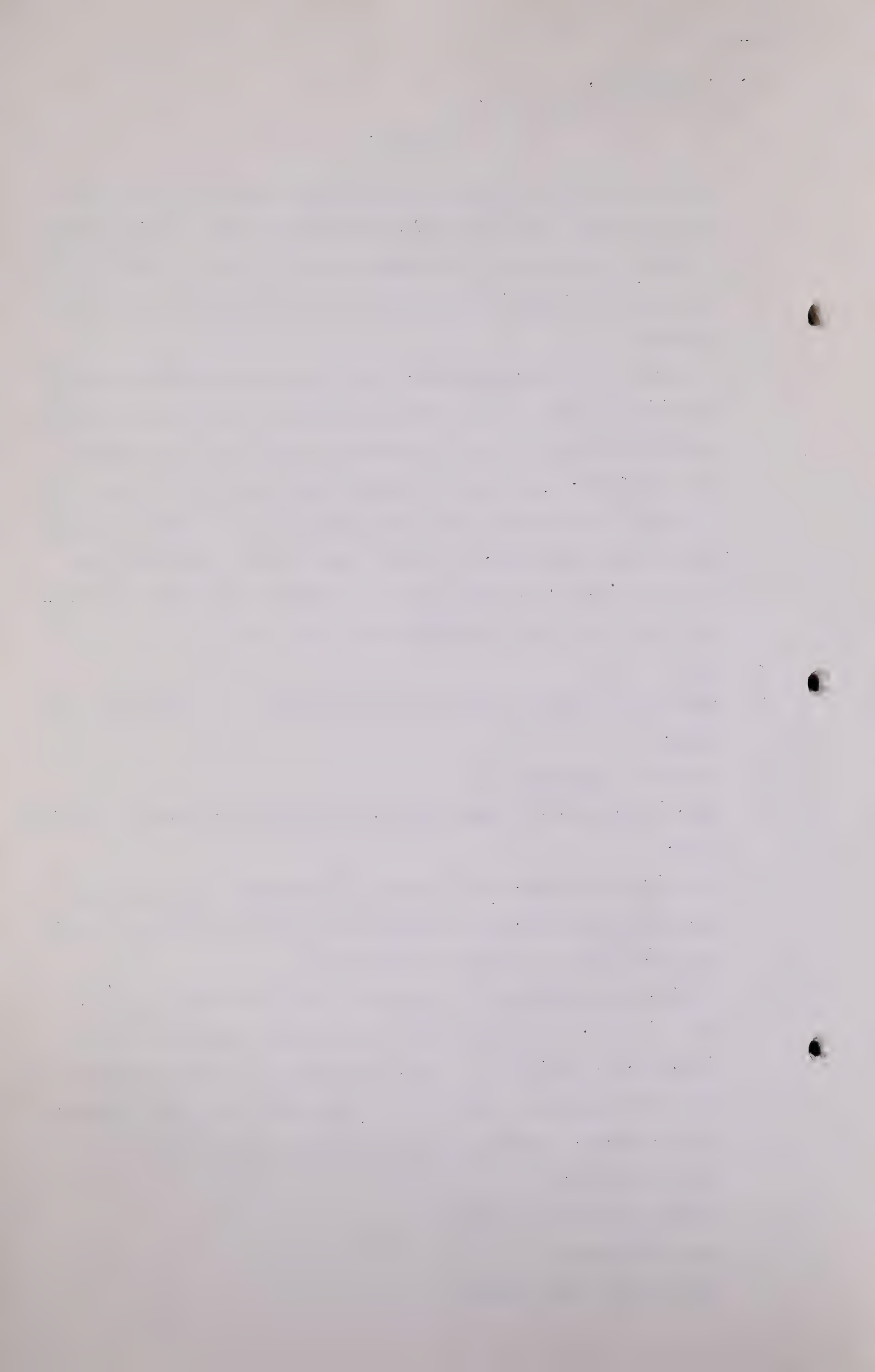
Q Then in that event, as far as the consumers as a whole are actually concerned, the valuation is a fair valuation. That is the point that I wanted to make clear?

A I was just wondering if it did not work the other way, Sir, that is all. The pipe line which had the original cost of \$100,000.00, taking it at 10%, or taking it at an assumed value of ten thousand, would have a value for rate base purposes of \$55,000.00, and the one that had an original cost of \$200,000.00.....

QNo, put in the same?

A Put in the same?

Q Both at the same figure?



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Cross-Exam. by Mr. Chambers.

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A And the one handling 50 million rather than 100 million?

Q Yes?

A It is the field rather than the cost.

Q Yes.

A 10% salvage, they would both have the \$55,000.00 value.

Q But one did not have any salvage. What I had in mind, you would entirely amortize one, whereas the handling of only 50% of the gas would not amortize the one that could only handle 50 million cubic feet. There was a difference in use.

A There are two ways of treating salvage, but the method which we have followed would result in the same terminal value for it.

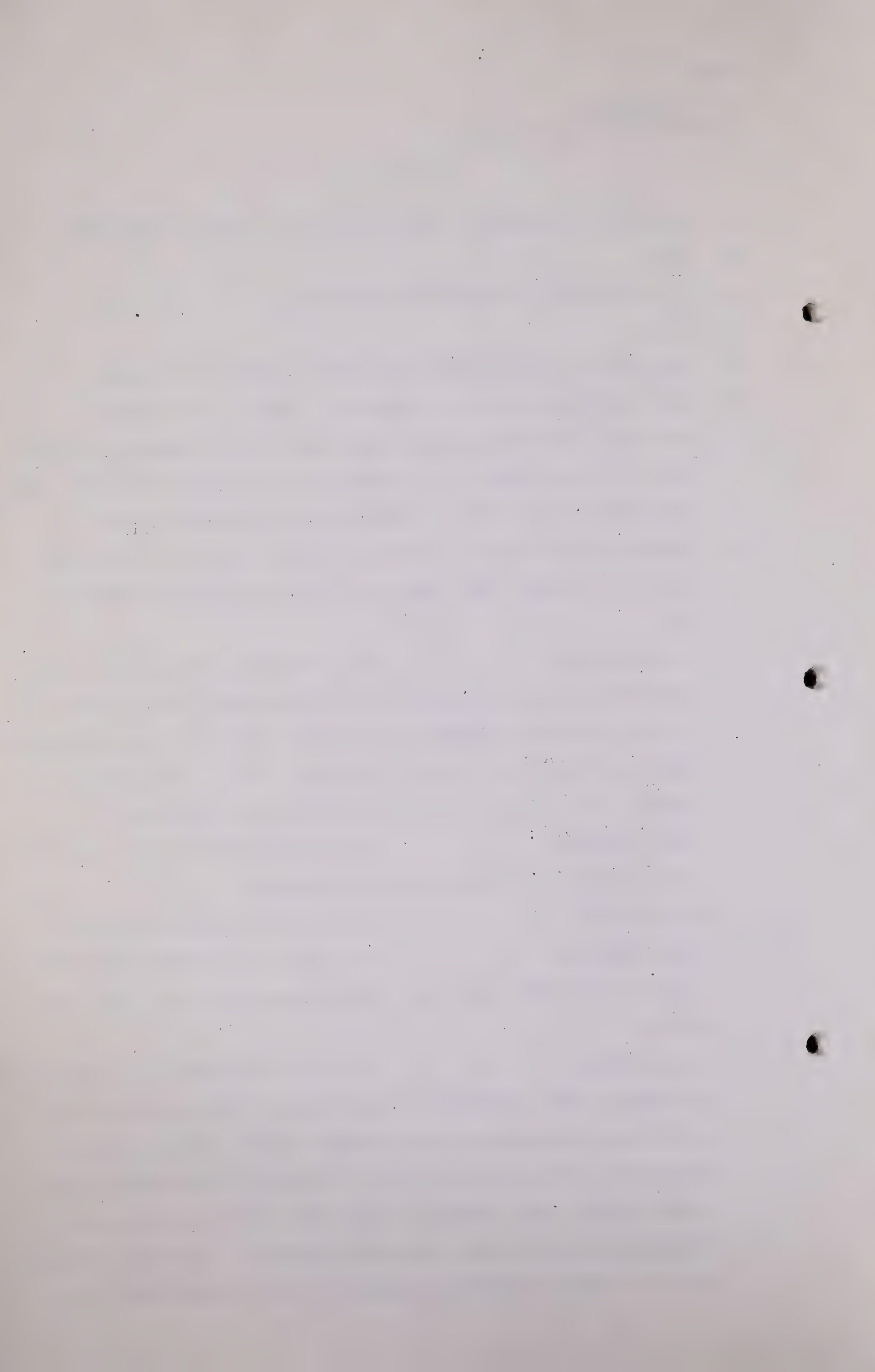
MR. BLANCHARD: Mr. Chairman, part of the cross-examination of Mr. Hamilton took place while I was absent, and I have not had an opportunity of going over the cross-examination with Mr. Hamilton. It might be that I would like later to re-examine him on some of the points that were taken up.

THE CHAIRMAN: Well, that concludes Mr. Hamilton's evidence on rate base and rate of return.

MR. McDONALD: Rate base and working capital.

THE CHAIRMAN: Rate base and working capital, yes. You have something more from Mr. Donellan, now, have you, Mr. Harvie?

MR. HARVIE: Yes. Mr. Chairman, I am just going to suggest that possibly we might proceed with Mr. Donellan's additional information that we wished filed now, and then immediately following that, if it would be agreeable to the other Counsel, Mr. Hamilton might deal later on today or tomorrow, deal with the operating expenses of the B.A. system, which we might be able to complete before Mr. Donellan left,



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THE CHAIRMAN: All right.

MR. HARVIE: I had not expected that we would make the progress today that we have. I, therefore, suggest that.

.....

ROBERT DONELLAN, re-called,
already sworn, examined by Mr. Harvie, testified as follows:-

THE CHAIRMAN: You are still under oath, Mr. Donellan?

A Yes.

Q MR. HARVIE: All right, Mr. Donellan.

A With reference to Volume 42, pages 3224 to '29, cross-examination by Mr. Chambers, in connection with Exhibits 102 and 118.

Q MR. BLANCHARD: Will you give the page again?

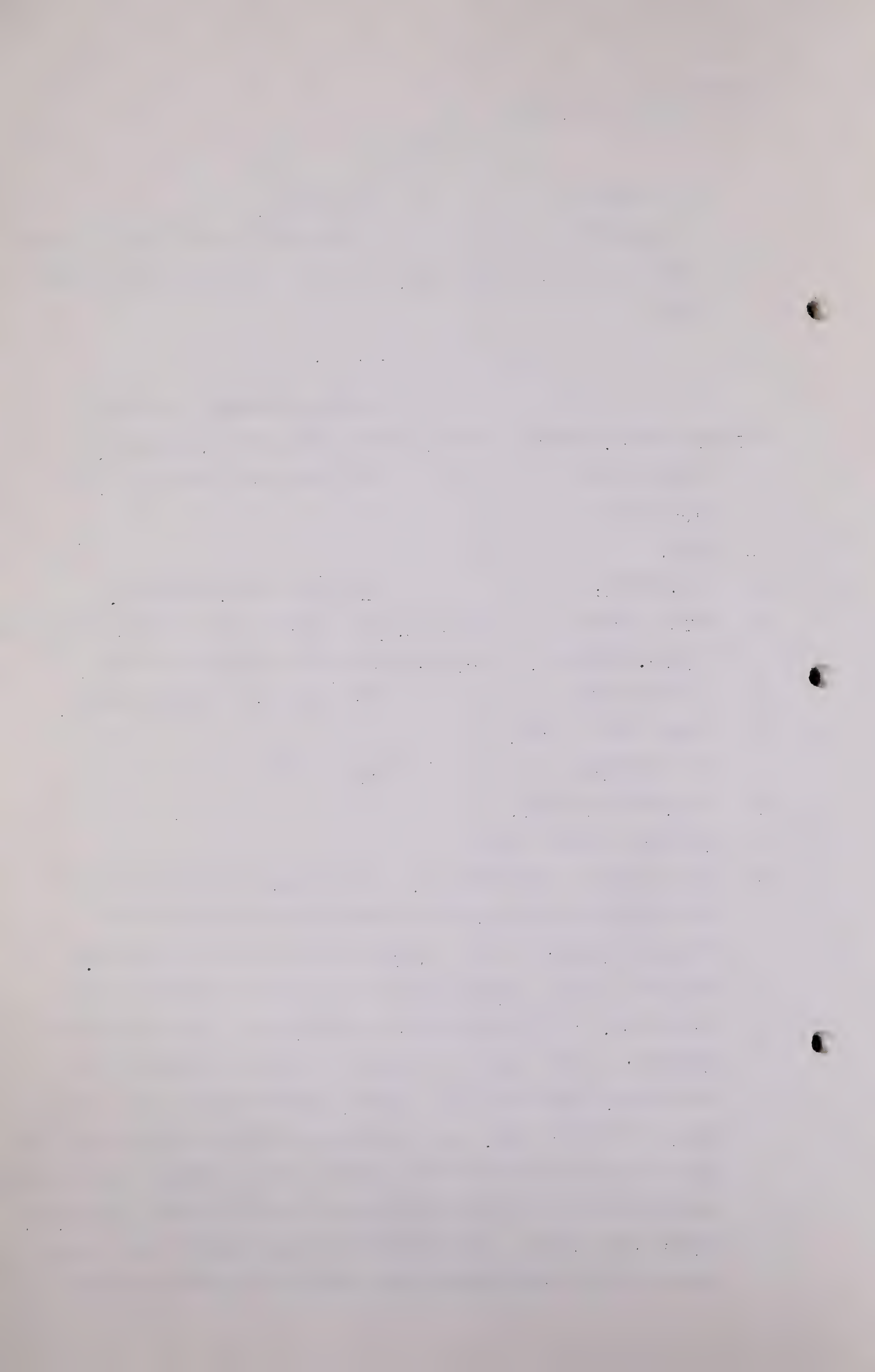
A Pages 3224 to '29.

MR. CHAMBERS: 3224 to '29?

A Yes, 3224 to 3229.

Q Exhibits 102 and 118?

A Yes, Exhibits 102 and 118. It was agreed that there would be an opportunity for me to examine and check Madison's statement, Exhibit 102, showing a total value of \$91,726.02, and that I would report back to the Board on completion of this work. The representative from B.A. met with the Madison Company's staff and as a result of detailed analysis of the statement, adjustments for meters, rights-of-way, etc., were made to Exhibit 102. As a result of this work a statement is now attached showing valuation of B.A. high pressure gas gathering system which is to be turned over to the Utilities, using E. G. Hill's unit costs. The total of this statement, which is now agreed on as being substantially correct by representatives



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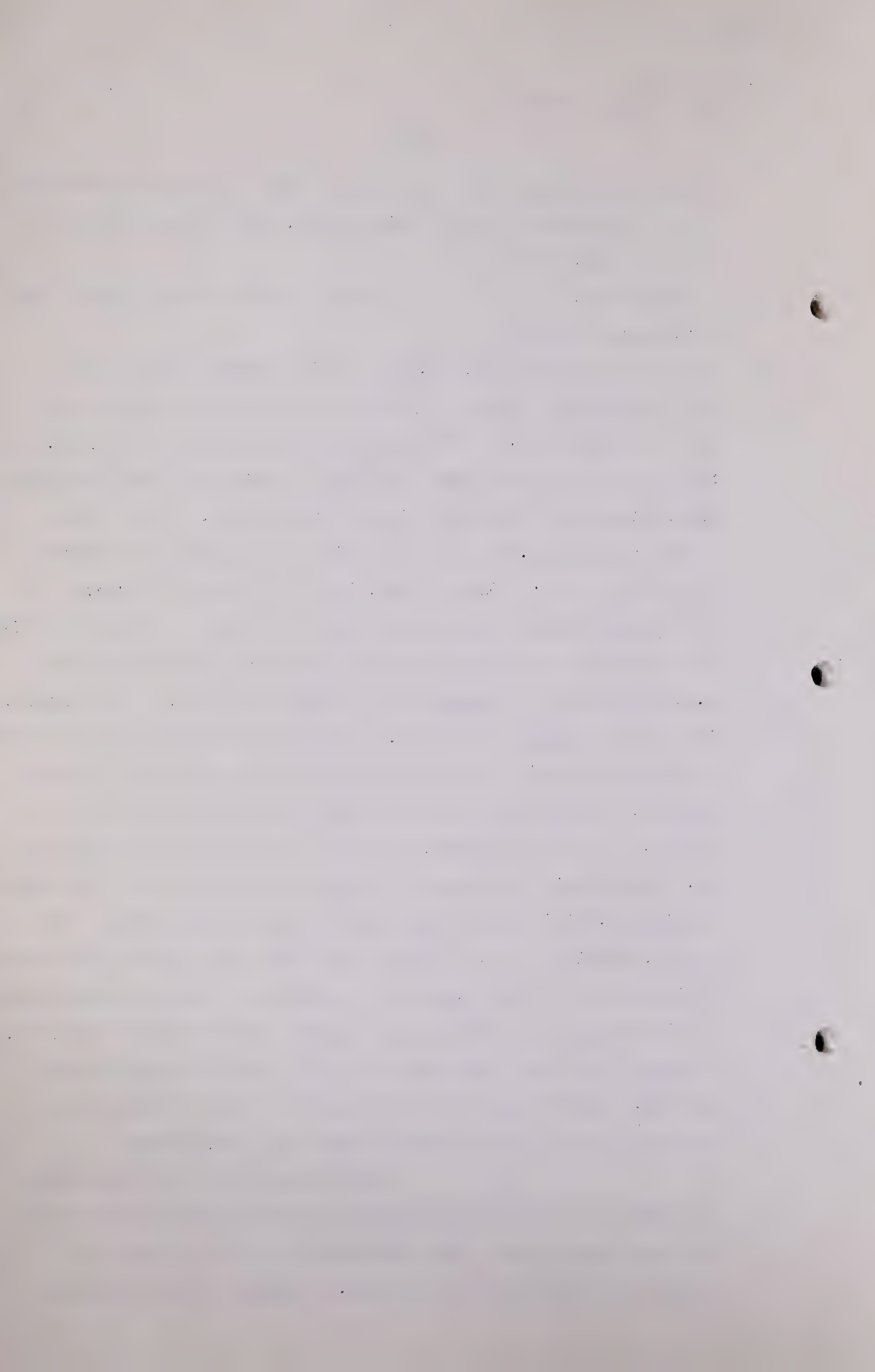
- 4636 -

of both companies, shows an adjusted value of total reproduction cost less observed depreciation on Mr. Hill's basis of valuation of \$109,452.45.

Q MR. BLANCHARD: Is that instead of one hundred and fifty-four thousand?

A That is instead of \$91,726.02. It is submitted that while this information might be of interest it does not reflect any fact of importance. It is based on an assumption of how Mr. Hill might have valued the B.A. plant and assuming that both gas gathering systems are comparable in all particulars. This is not a fair assumption. Possibly there is a fair comparison insofar as pipe and cost of laying pipe, but with regard to motors and other miscellaneous equipment, I see no reason to assume that Mr. Hill would have followed a similar method of valuation for the B.A. plant that he adopted for the Madison plant. There is one item as an example: The B.A. system was constructed on the basis of 150-170 pounds pressure, whereas the gas gathering system of Madison, I understand, takes pressures from 60 pounds to 325 pounds. I have, therefore, prepared a statement attached using Mr. Hill's basis of values as to pipe and laying costs but reinstating Mr. Teis' values with observed depreciation rates for motors, fittings, etc., together with additions for rights-of-way, administration at the B.A. rate of 10% etc. This statement shows a total reproduction cost less observed depreciation of \$129,328.48. I submit that this statement is a more accurate valuation of the B.A. system using Mr. Hill's methods than the previously referred to statement showing a total of \$109,452.45.

Both Messrs. Hill and Teis added the overhead charge for administration on the depreciated value of their appraisals. This percentage, 9% in the case of Madison and 10% in the case of B.A., should I feel, have been



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taken on the replacement cost, not the depreciated value, and in turn depreciated 5.6% by Mr. Hill but not depreciated by Mr. Teis, who took the full depreciation on tangible assets. However, since both independent engineers did use depreciated value as a basis for calculating administration and overhead charges, there has been attached to the statement of \$129,328.48, a supplementary schedule adjusting the amount of overhead by \$2,985.69, leaving a net value for the B.A. gas gathering system of \$126,342.79.

Q MR. HAMILTON: Would you give that one again?

A \$129,328.48.

Q And that compares?

A With the \$126,342.79.

THE CHAIRMAN: And the original is 154 is it not?

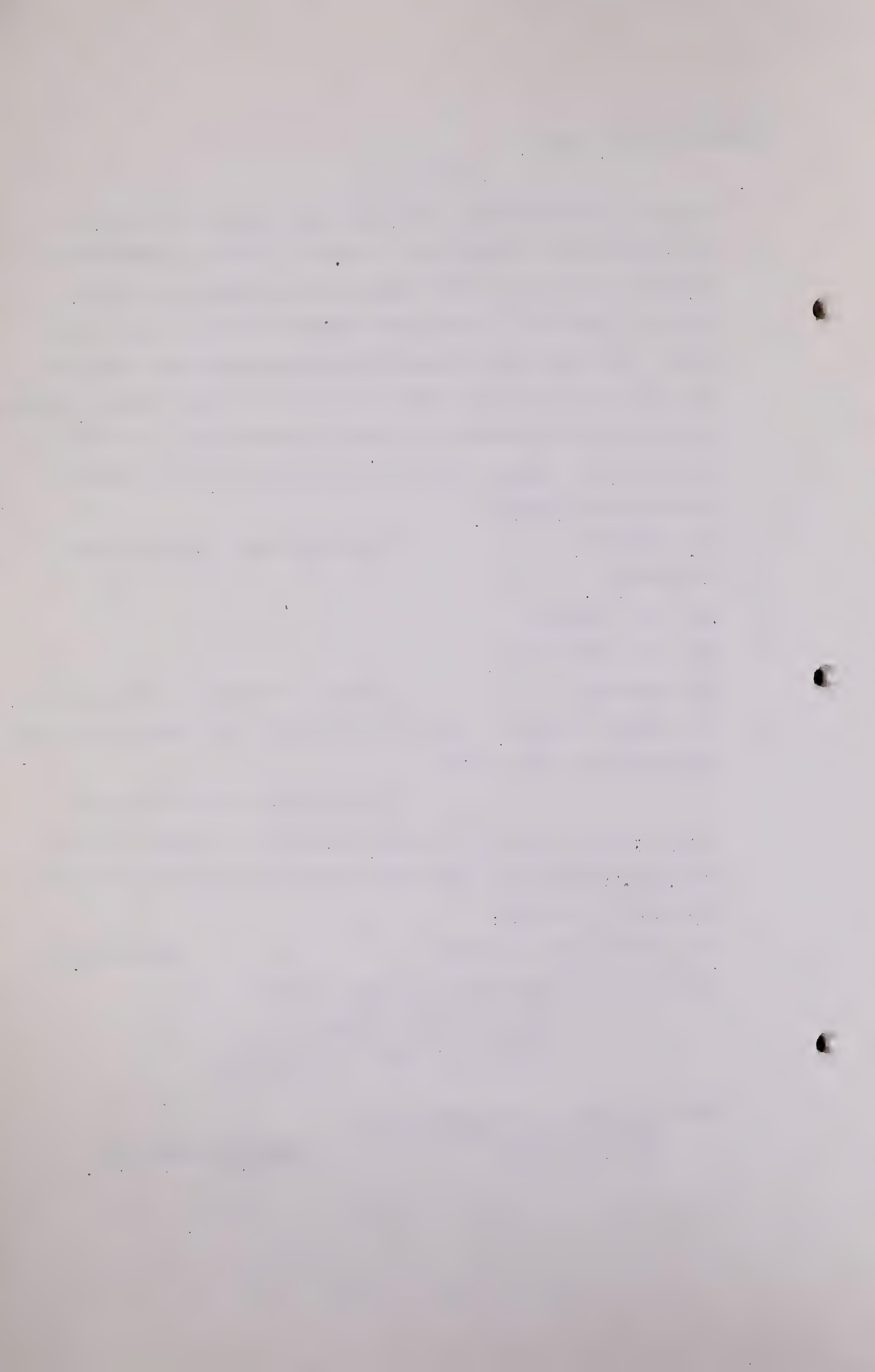
A The original is 154. Copies of this are being prepared and will be given out to all of you.

A reconciliation between the original Teis appraisal of \$154,545.27 and the above amount of \$126,342.79 shows the following explanation with regard to the difference in values:

The original Teis appraisal	\$154,545.27
-----------------------------	--------------

Labour Costs - being the difference between cost to lay as used by Teis (being the rates charged by Gentry Co. in 1944) and the 1943 labour costs used by Hill	\$28,644.90
--	-------------

Administration, occasioned by the difference in valuation of tangible assets	<u>2,554.79</u> \$32,199.69
--	-----------------------------



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LESS:

Difference in depreciation due to
adjustment of pipe differences
and using an overall average
rate of 30% \$1,133.53

Difference of valuation of
pipe which is now valued on
a unit basis as distinct from
the basis followed by Teis 2,863.68

The sum of those two items is 3,997.21

and that makes a total of 28,202.48

and that total subtracted from the \$154,545.27 gives us the

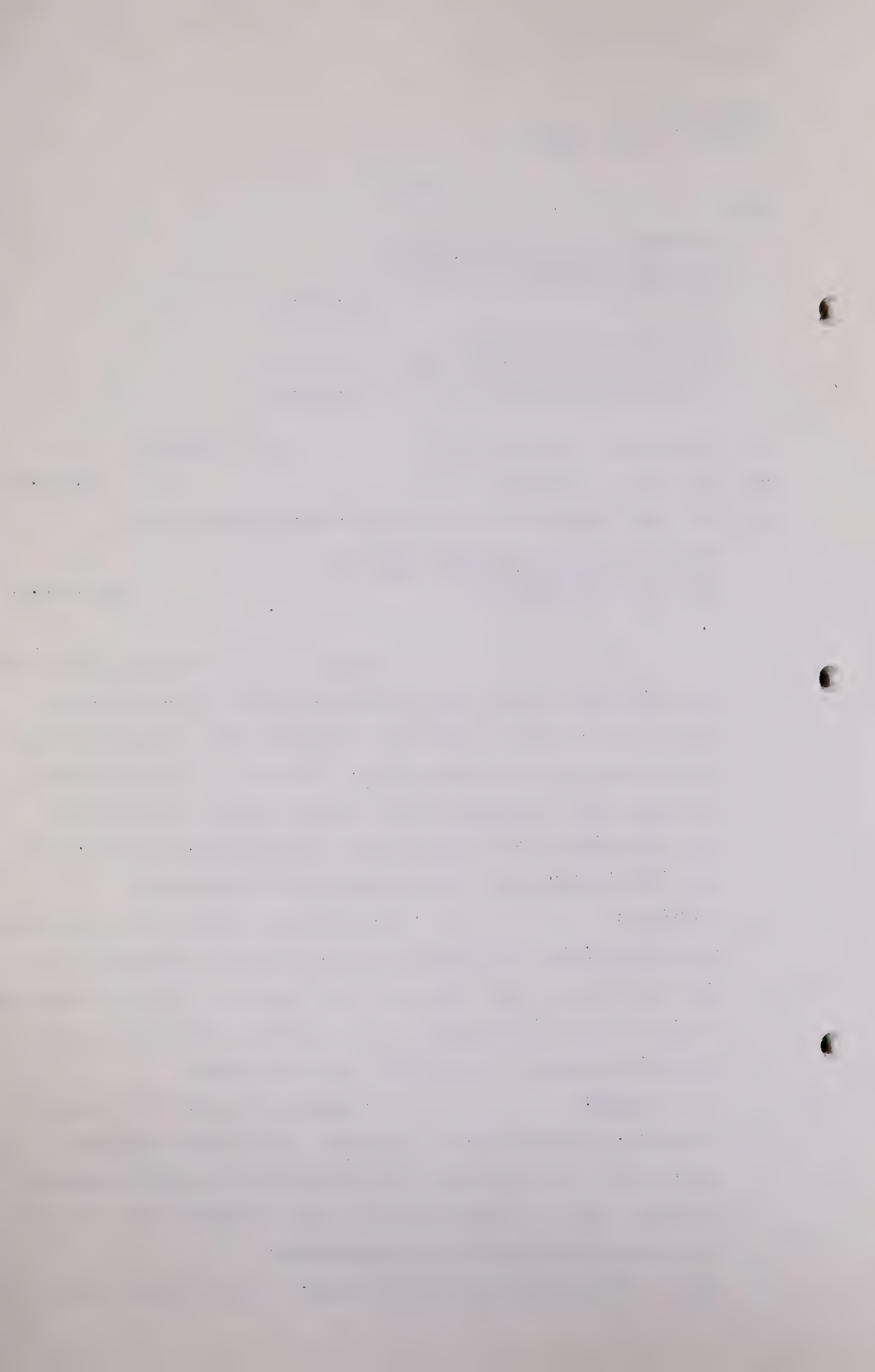
Valuation of gas gathering system on
basis of using E.G. Hill's computation
for pipe and laying of \$126,342.79

It will be seen from the above that the difference between the Teis appraisal and the same assets valued on Mr. Hill's method, is practically all accounted for due to the difference of labour costs. The cost to lay at the time of taking Teis' appraisal was the prices actually charged for such operation at the time he took his appraisal, while Mr. Hill took 1943 labour costs as the basis for his appraisal.

Q MR. HARVIE: Mr. Chairman, there are some supporting statements giving the detail in that, and it is proposed that we will file those. They are now in the course of being got together. We did not anticipate being as far advanced as we are now, as to require them, so that we will file them later.

Q MR. CHAMBERS: Mr. Harvie, I wonder if I might interject. Mr. Donnellan, in the first part of your evidence, dealing with this statement, you stated that the Madison agreed on those. Now my instructions are that the matter was discussed but they had not seen the final statement.

A Well I just learned that at the recess. I was certainly under



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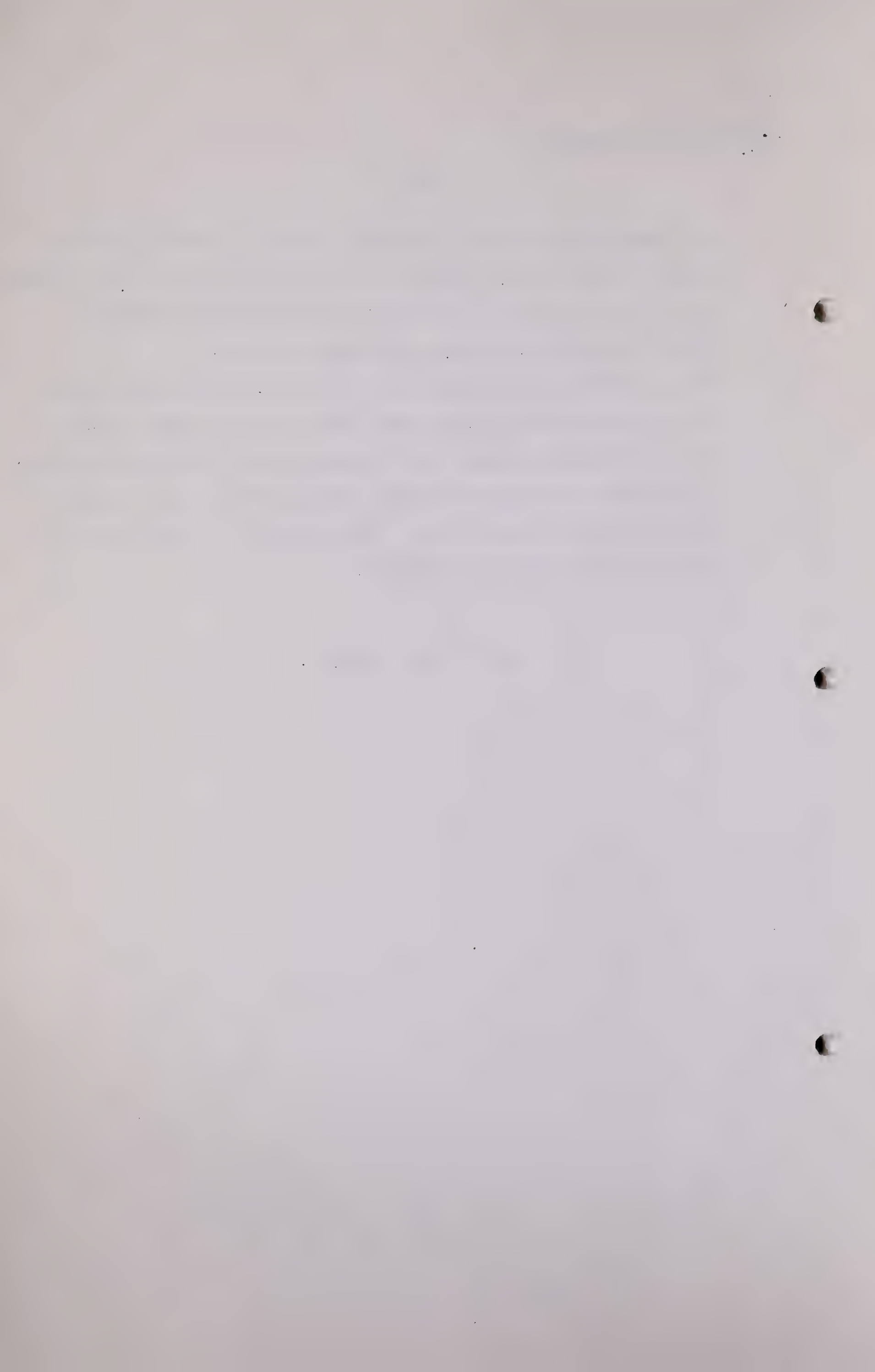
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the impression that the two staffs had got together and had agreed on the amount, and it was only at the recess that I found out the statement had not been given to Madison's office.

Q Those are my instructions, with regard to that.

A Yes, that is what I learned at the recess, but I am satisfied that Madison's staff were agreed with regard to that. There was a misunderstanding, and I thought that those had been given. I was under the impression when I was in Calgary that it was to be delivered to your office. Unfortunately, I discovered this morning that it was not delivered.

(Go to page 4640.).



T-3-1 12.10 P.M.

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While that additional statement was prepared, I proceeded to do a corresponding comparison with regard to the water system so that they would be both on the same basis. On page 3 of that report are these notes: -

In view of the foregoing memorandum in connection with a comparison of the Hill and Teis appraisals, a computation on a similar basis applied to the valuation of the water system is attached. This statement shows that there would be a reduction of \$4,336.73. This reduction is accounted for:

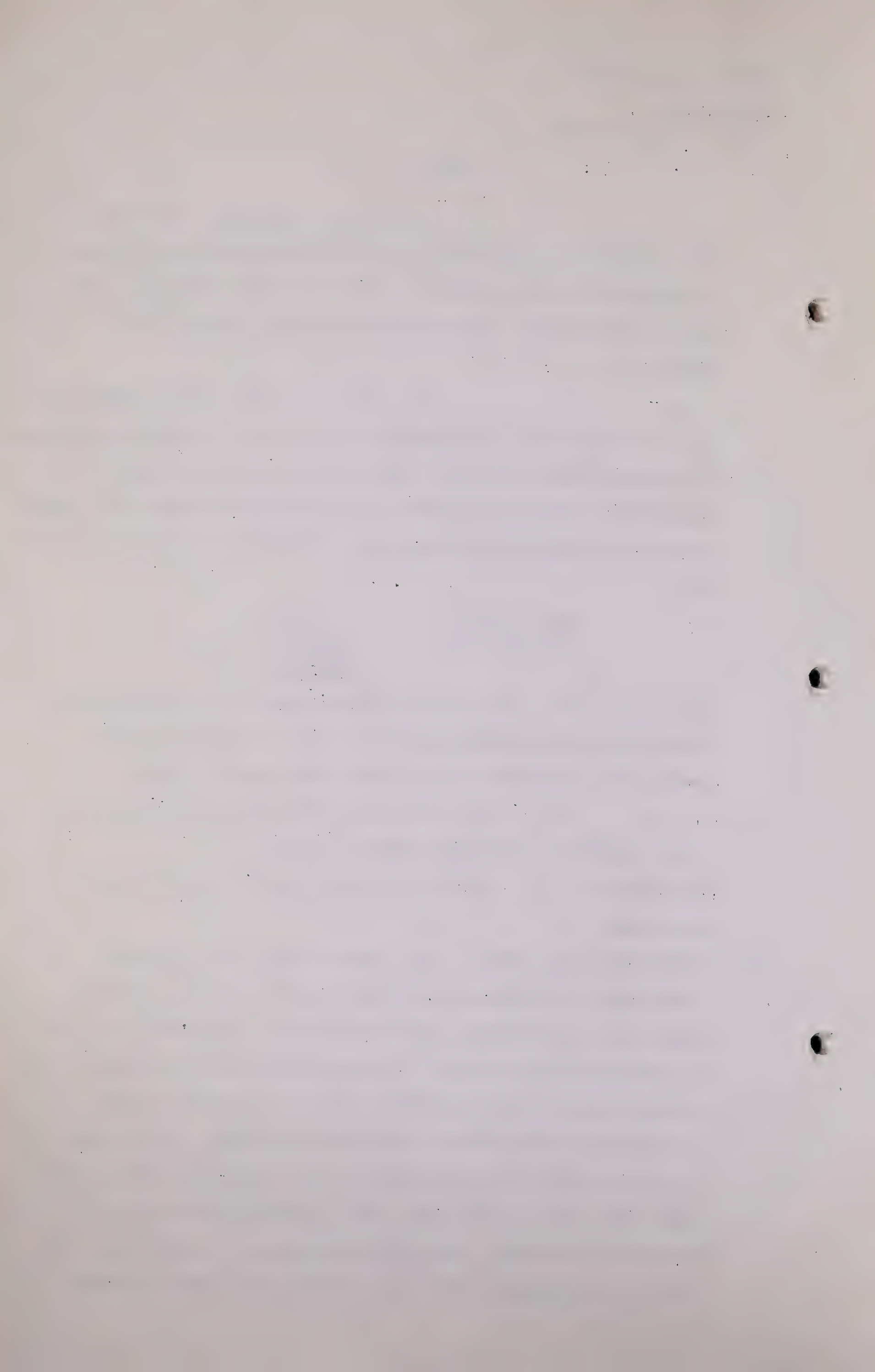
Cost of Pipe	\$78.08
Cost to lay	<u>4258.65</u>
	<u>\$4336.73</u>

As in the case of the gas gathering lines, the reproduction cost used in the submission was based on Gentry contract rates whereas Hill's was based on 1943 labour costs.

In connection with Volume 42, page 3242, cross-examination by Mr. Chambers re taxes.

MR. STEER: Would you please give me that volume and page?

A Volume 42, page 3242. Mr. Chambers was inquiring with reference to the amount of taxes shown on page 8, Exhibit 113A and I pointed out at that time, that this statement was an estimate of the amount of taxes which would probably be charged against the operations, also an estimate of the allocation to the various operating sections. At the time of giving evidence, I pointed out that taxes had not at that time been paid but that when the tax assessments and tax bills were received, they would be subject to scrutiny. We have since received tax bills for the year 1945 and attach



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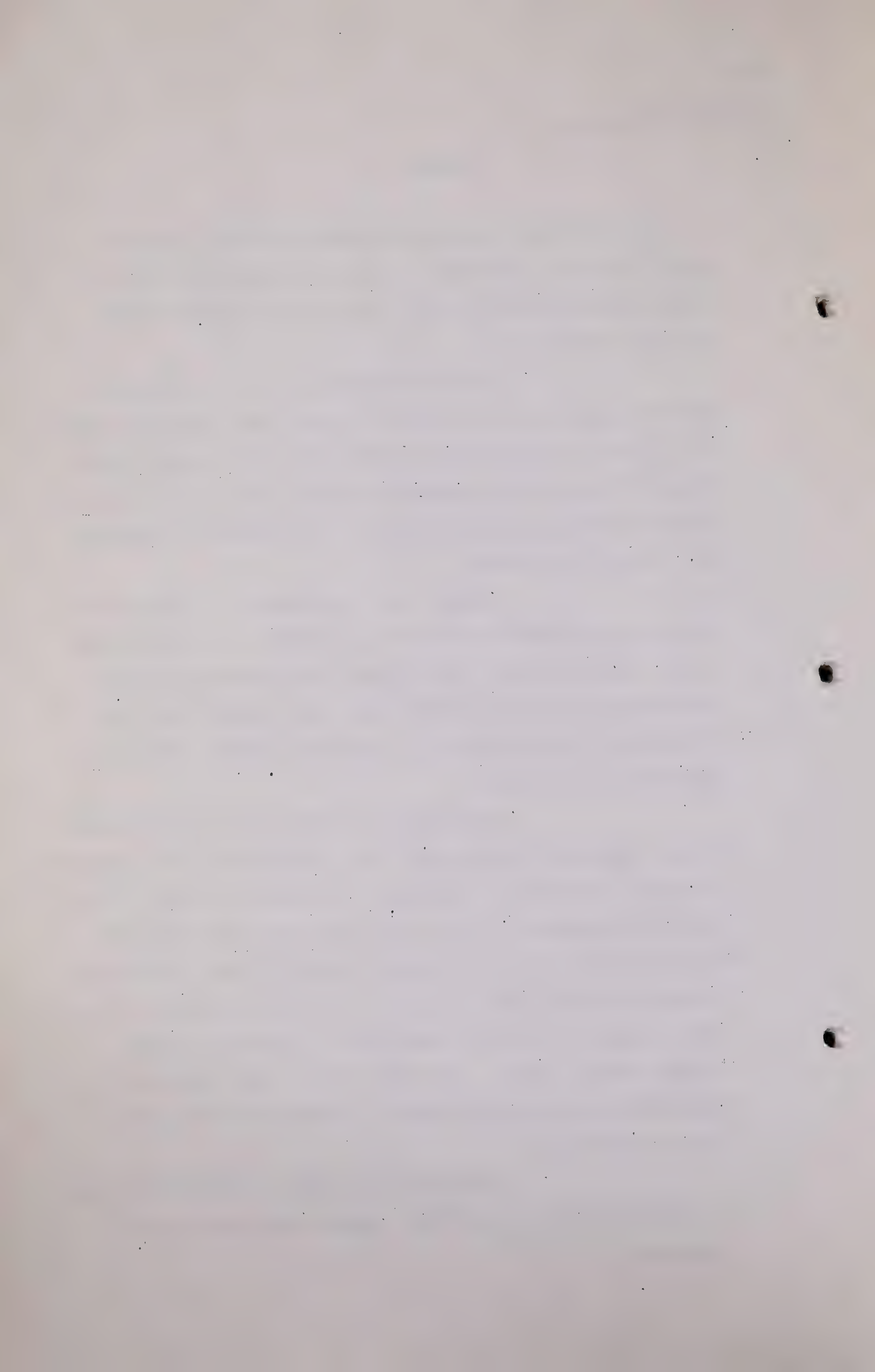
a summary statement showing a breakdown of the assessed value and how the tax bill is compiled, together with the amount charged to each of the various Departments of the Utilities operations.

It will be noticed that the estimate in Exhibit 113A amounted to \$3,957.00 while the actual tax bill for the year amounts to \$3,885.29. The allocation of these taxes to the various Departments is on a basis of the assessments which has been levied by the tax authorities against the various Departments.

Attached is a statement. I think your question, Mr. Chambers, was with regard to the amount shown for the high pressure line as being an exceptional amount, whereas the actual amount that has gone through the line to Madison is only carrying a charge of \$19.38. That statement will be attached.

Volume 42, page 3246. Cross-examination by Mr. Chambers re certificate from engineers as to inspection of pipe. Answering Mr. Chambers' inquiry as to certificates from the inspectors of used pipe which was purchased and copies of inspectors' reports in respect of the 71,084 feet 4 inches of used pipe have been filed with the Board. The total amount of used pipe used in the installation was 77,040 feet 10 inches. In other words we had engineers and inspectors' certificates covering 71,000 out of 77,000 actually purchased.

Volume 42, page 3265. Cross-examination by the Chairman and page 3287 - Cross-examination by Mr. Blanchard.



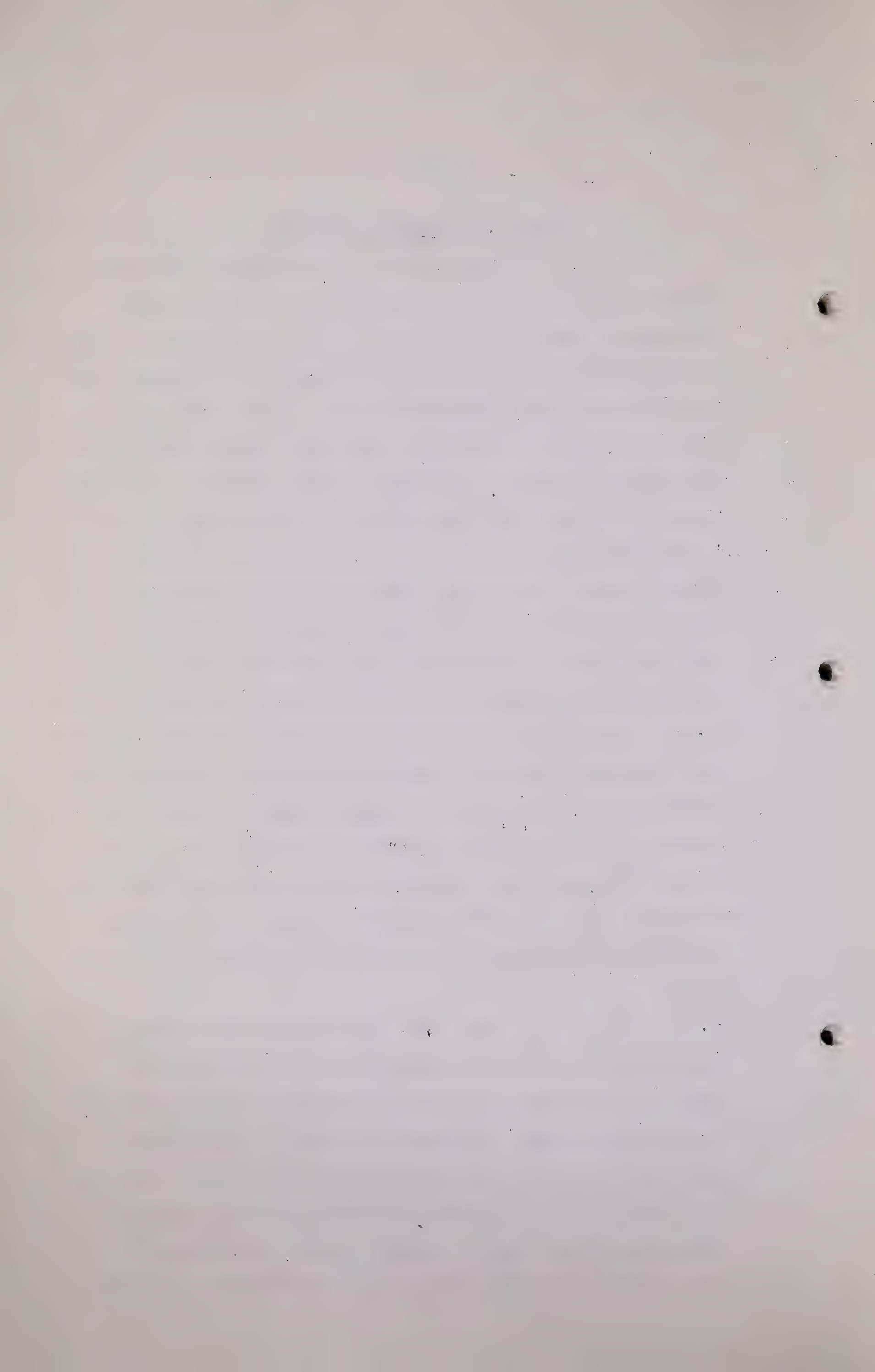
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COST OF ALTERNATIVE SCHEMES

Page 3265 - Mr. Blackstock requested "why did you not adopt that method (reducing working pressures) instead of spending all the money you spent on a low pressure system?" He also commented "the reason you did not reduce the pressure because, had you done so, you could not have recovered the iso-butane without installing an enormous amount of equipment in your reduced low pressure plant." He then went on asking me to assume that, if we could not recover iso-butane by lowering the pressure at the plant without installing a vast amount of new equipment, and though he realized we had not done so, he further asked me to assume that if this amount had been spent, would I agree that B.A. Oil Company Limited, would have paid for the equipment? On the basis of these assumptions, I agreed. He then went on to say that as we were now achieving the same result "why should not the B.A. Oil Company Limited stand a substantial portion of that expense?" I replied that, as a matter of policy, the Company had not entertained the idea of going into the capital expenditure, his retort being "and is not iso-butane the answer?", and asked me to find out.

Page 3287 - Mr. Blanchard referred to the Chairman having two alternatives if we wanted to recover iso-butane; one being to lower the pressure in the high pressure line. He again referred to the Chairman having asked me to assume that that would involve outlays for installation. The other alternative was to put in a low pressure system, as has been done. Mr. Blanchard requested to know when these two alternatives were first

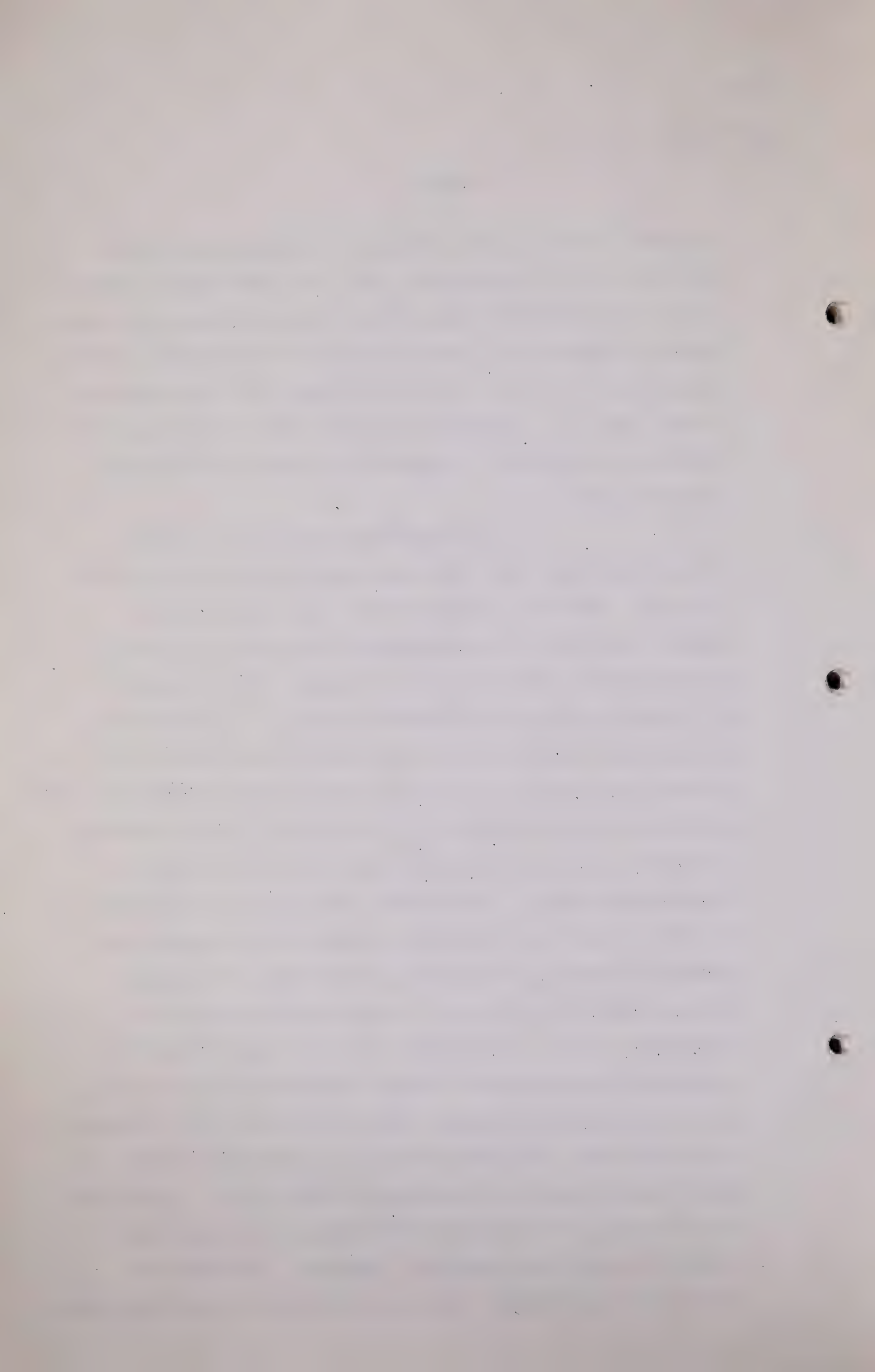


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discussed by the B.A. Oil Company. I pointed out at that time that I had no knowledge of when they had been discussed and should have added, even if they had been discussed at all. However, I promised to make inquiries of the officials of the Company and to be in a position to comment on this matter at a later time. Mr. Blanchard requested that my inquiries be made as to discussions, irrespective of the time at which they were made.

I have discussed the matter with the Company's Manufacturing Department and all senior executive officials. Both Mr. Blanchard's and Mr. Blackstock's comments were part of my discussion with senior officers of the Company and the basis of my inquiries both at Toronto and Calgary; also at the Absorption Plant. As a result of my inquiries I found that the only suggestions made by the Operating Department or the engineering or administrative staffs was that we should proceed with the policy of either reducing our Plant pressures and/or possibly the installation of a low pressure system. No estimate was prepared at any time nor have I found any reference anywhere to any contemplated request for capital expenditure, which would be necessary in the event of a reduction of operating pressure at the Absorption Plant. In connection with the possibility of installing a low pressure system, a suggestion was made by Mr. J. A. McCutchin in April, 1943, that application be made to proceed with the installation of a residue gas system which would require an expenditure of \$47,000.00. I gathered that a proposal in connection with this project had gone forward to Allied War Supplies. However, the executive officers of the Company advised Mr. McCutchin on May 18th, 1943



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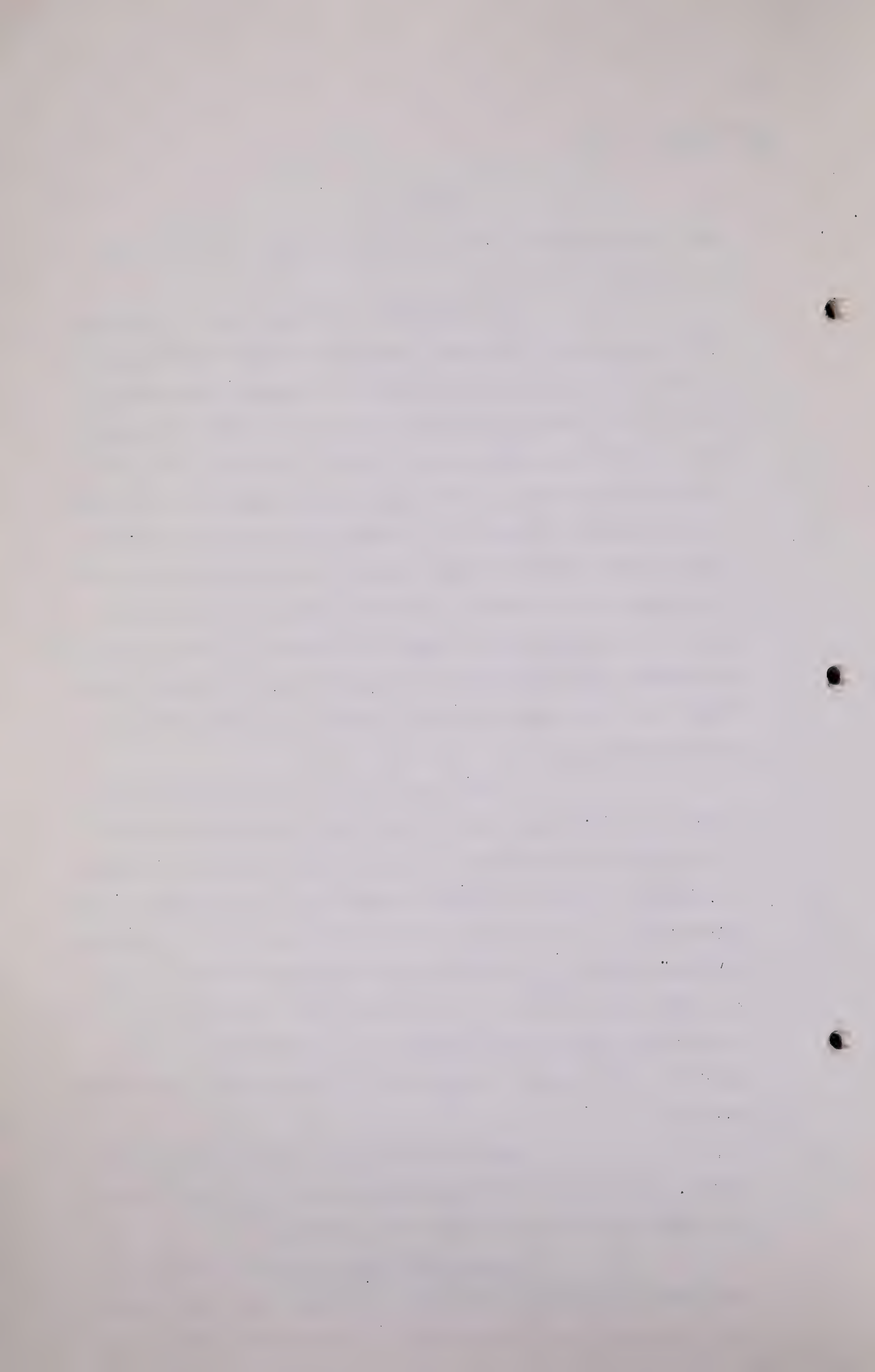
that his suggestion that the Company spend this money was not approved.

In connection with the urgent necessity and importance of obtaining iso-butane, which was stressed by the Chairman, our Company did ask the Alberta Conservation Board for authority to produce wells on an annual allowable basis so that iso-butane would not be interfered with. From a letter written by Mr. McCutchin to the Allied War Supplies, the Conservation Board had apparently informed him that the request would not be granted since they had no knowledge of a shortage of iso-butane. Following this matter up with Allied War Supplies their reply on December 21, 1943, was that the matter should be left in abeyance since "it appears that there is a total surplus rather than a deficiency of iso-butane at Calgary."

I have been advised by our engineering staff, that in their opinion, the lowering of pressures at the Absorption Plant would not, of itself, necessarily incur "enormous" or "vast" capital expenditure. In connection with this matter I find that, in June 1943, one-third of the Plant was operated at a reduced operating pressure of 65 lbs for experimental purposes. It was found that operations could be successfully carried out other than in exceptionally hot weather. No capital expenditure was incurred for their test period.

Some further notes dealing with several matters referred to in cross-examination of R. Donellan by the Chairman and the late Dr. E. H. Boomer.

On page 3256 (Vol. 42), the Chairman requested information as to the additional cost involved in complying with the Boiler Inspector's demands relative to



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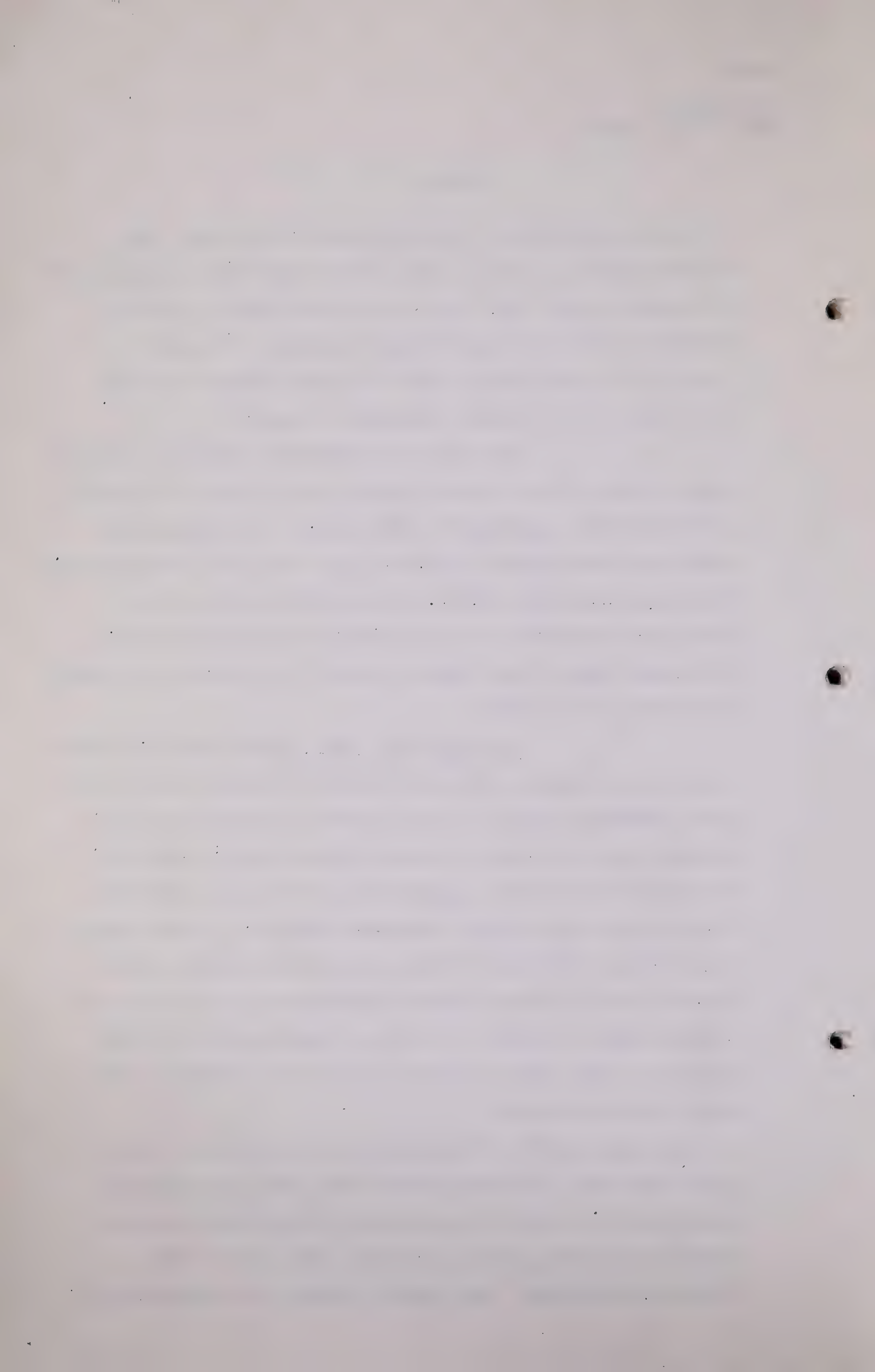
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the fuel gas scrubber. As far as can be estimated, the amount involved in meeting the Boiler Inspector's requirements was approximately \$1300.00. As the work itself was done simultaneously with other work on the unit, it is not possible to specifically state the actual amount involved as a result of the Boiler Inspector's demands.

In this same connection enquiries disclose that the cost of new towers, similar to the ones in question, would have been approximately \$8,000.00. By using second-hand towers available at \$200.00, plus the cost of dismantling, shipping, re-erecting \$2,655.00, plus the extra cost of \$1300.00 in complying with the Boiler Inspector's demands, the actual cost of the towers amounted to \$4,155.00, resulting in a saving of \$3,845.00.

On Page 3258 (Vol. 42) the late Dr. Boomer asked to be supplied with a statement showing the cost of the fuel scrubbing unit at the low pressure compressor station, together with the cost of the new Girbotol unit; similarly, a statement showing the expenditures of the fuel scrubbing unit at the high pressure compressor station. He also asked for a similar statement covering the cooling water installation at each station; also an estimate of the cost of such installations together with volume of gas scrubbed and the capacity of the plant to scrub gas and the capacity of the water cooling systems.

(a) In preparing the information asked for above, I would point out that, in connection with the fuel gas scrubbing unit, there is only one installation at the high pressure compressor station, which scrubs the gas used at both compressor stations. The amount included in our submission,



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Volume 2, Supplement 1, Exhibit 102A, amounts to \$11,691.11. Attached is a copy of Schedule A I referred to, giving details of that \$11,691.11.

(b) The cost of the Girbotol process fuel gas scrubbing unit amounts to \$7,969.92 (See Schedule "B" attached.)

(c) Our Engineering Department have prepared an estimate of a similar Girbotol scrubbing unit new, the cost of which would have been \$13,200.00.

Schedule "C" attached gives details of that estimate.

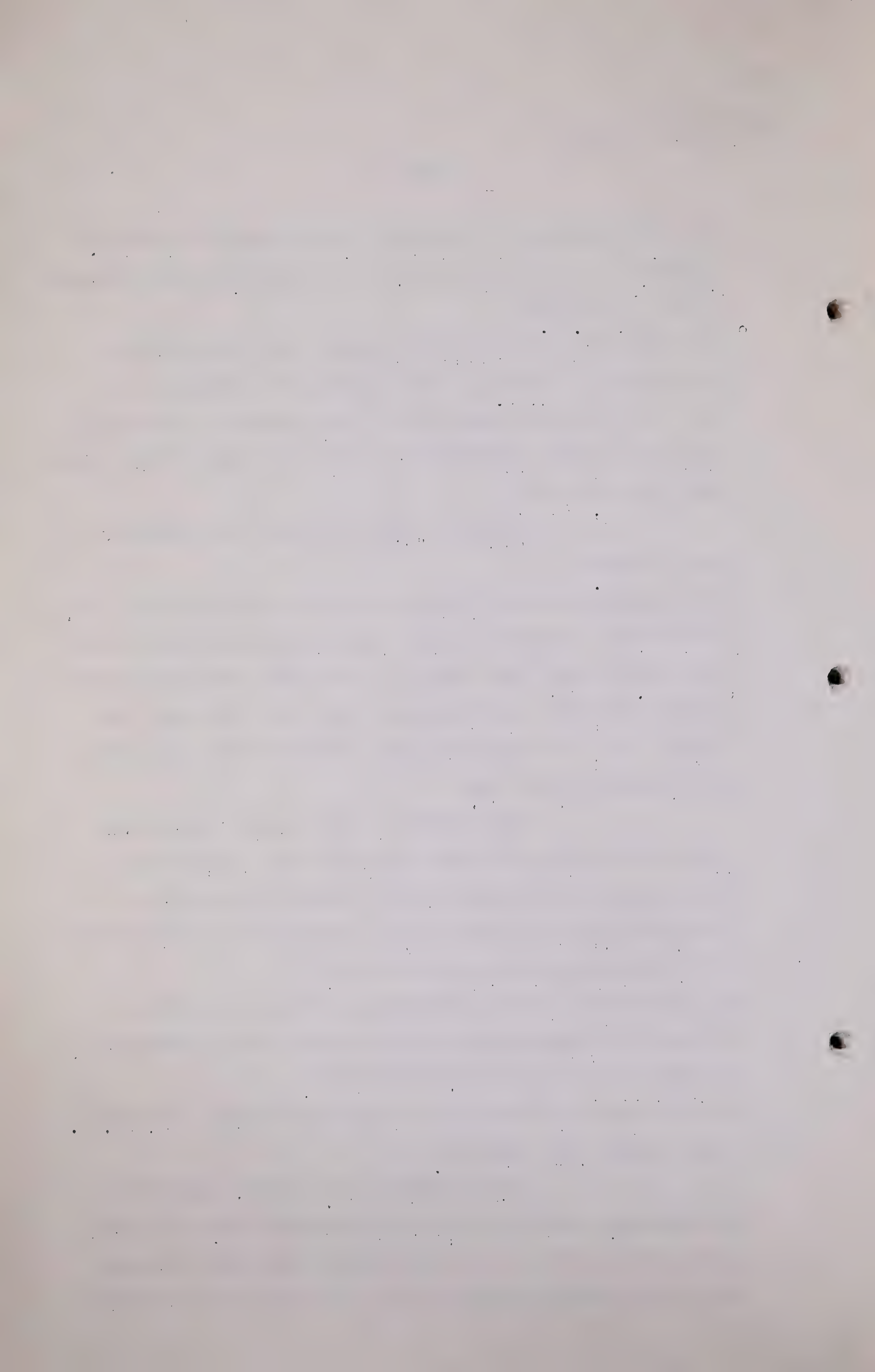
(d) The quantity of gas scrubbed from January 1st to July 31st, the time the original fuel gas scrubber was abandoned, amounted to 114,057 mcf. The quantity of fuel gas scrubbed in the new Girbotol fuel gas scrubbing plant, from the time the original plant was abandoned up to October 31st, amounted to approximately 87,000 mcf.

With regard to the request for information covering cooling water installations, attached are two schedules showing analysis of expenditures made in connection with the water cooling systems at the low pressure and high pressure compressor stations.

(a) The system at the low pressure station cost, after inclusion of Administration and interest during construction, \$19,411.59. (See Schedule "D" attached).

(b) The system at the high pressure station cost \$24,059.62. (See Schedule "E" attached).

With regard to Dr. Boomer's request for an engineer's estimate of similar equipment new, our engineers point out that there is no better basis for estimated cost new of similar equipment than the actual cost incurred



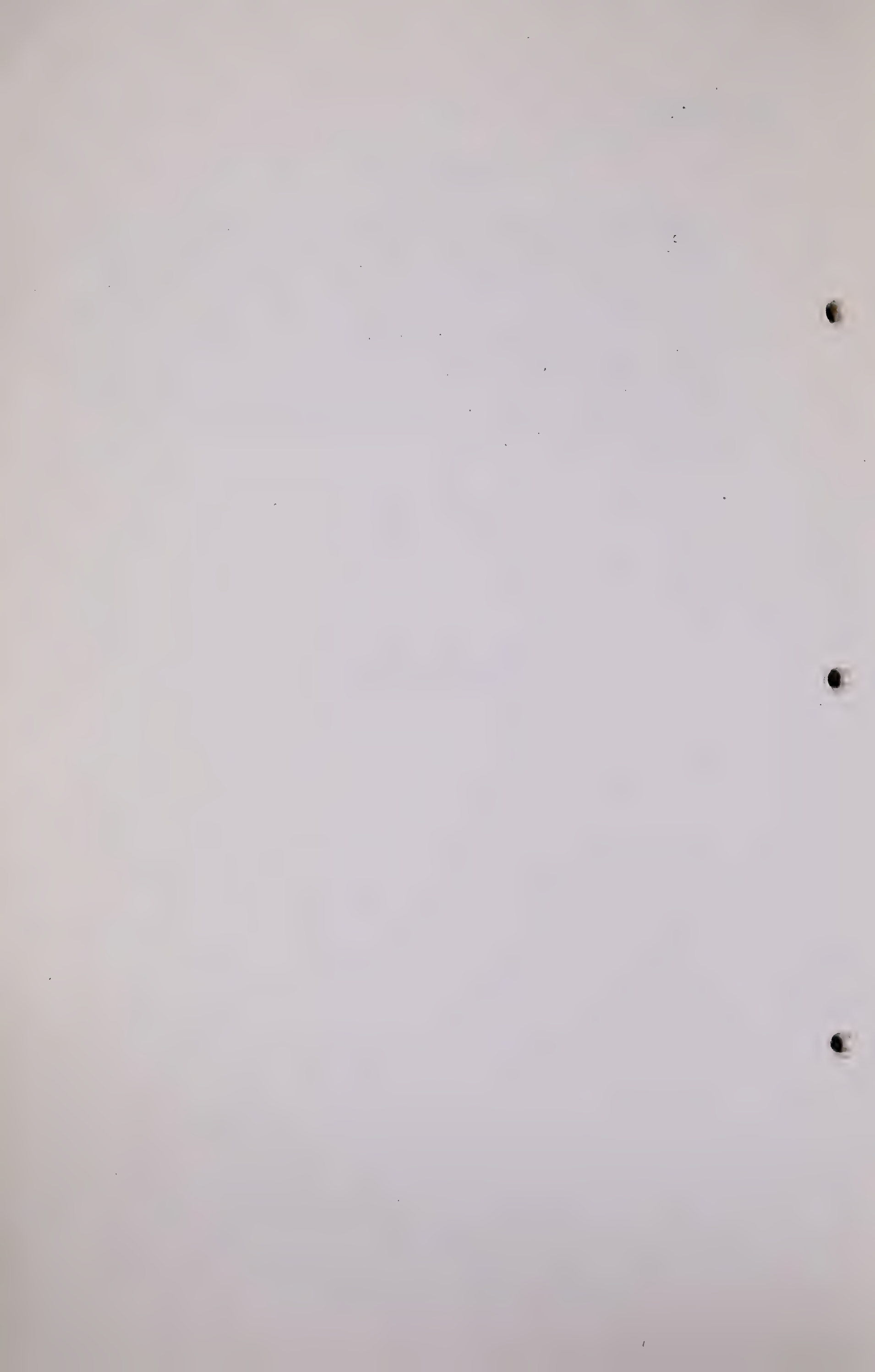
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R. Donellan,
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of these two particular installations. They were constructed new; all lumber and all the coils were new material. The only case where used material was employed was in the 6 inch headers and a few miscellaneous fittings, amounting to approximately \$800.00 at the low pressure station and approximately \$1100.00 plus \$1200.00 De Laval Steam Pump at the high pressure station.

(Go to page 4648)



C-3-1 12.27 p.m.

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Dir. Exan. by Mr. Harvie.

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In connection with the cost of the cooling water installation at the high pressure compressor station, it is necessary to point out that the original plans called for the installation of a spray pond. During cross-examination, Mr. Blanchard and the Chairman referred to an invoice for \$330.00, being work incidental to levelling the spray pond site. It was inferred, and I agreed, that this expenditure apparently was one of the items which I referred to as engineering hazards during construction. The inference being that the \$330.00 was in reality waste expenditure for which no benefit was derived. Further inquiry however, in computing the cost for the water cooling systems in answer to Dr. Boomer's inquiry, shows that this was a wrong interpretation. The \$330.00 referred to was billed as levelling site for spray pond. Actually, the site cleared was used for the water cooling tower at the high pressure compressor station and all work incidental to the levelling was necessary before proceeding with the foundations for the water cooling tower as finally installed.

Page 3258, Volume 42 - The Chairman also requested information as to the additional cost incurred by having the heaters installed after line construction was completed, as compared with the cost of installing these heaters during construction. I am advise by the engineering staff at the plant that the additional cost amounted to \$999.17; details are given on the Company's Schedule "F".

Then on Page 3261, Volume 42, the Chairman dealt with five different engineering hazards which had been brought out during cross-examination. He requested information as to how many more hazards of that kind there were. I had a member of the staff examine the ledger accounts and supply a statement of hazards of this nature, together with the cost of same. No additional engineering hazards were reported. The cost of the engineering

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hazards referred to is as follows:

1. Abandoned site for compressor base, north of Anglo-Canadian yard

Excavating for base, then refilling excavation	\$110.00	
Labour on forms	55.00	\$165.00

Excavating and erecting of forms was underway when this site was abandoned at the request of Anglo-Canadian, as being too close to their camp.

2. Pipe Disqualified for Use in High Pressure Transmission Line

Restringing of pipe in places where original pipe had been disqualified for use in High Pressure transmission line - 840' of pipe @ 12¢ plus 11%	111.89	
Welding cost on disqualified pipe, 23 hrs. : \$4.50	102.50	214.39

840' of pipe that was disqualified for use in the transmission line had been strung along the right-of-way. This pipe was moved over for use in the low pressure system and other pipe strung in its place at 12¢ (U.S.) per foot.

3. Levelling for Spray Pond

As will be seen in the notes answering questions submitted by the Chairman, investigation shows that the amount of \$330.00 for this item was wrongly classified as an engineering hazard.

NIL

\$379.39

4. Additional Cost of installing Heaters

This additional cost was also covered in the report answering questions submitted by the Chairman. Additional cost per Schedule F attached to report

873.75

Total items 1 to 4
To which we add 10% administration

\$1253.14

125.31

Plus interest during construction (3.9575%)

\$1378.45

54.55

FORWARD

\$1433.00

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CARRIED FORWARD

\$1433.00

5. Scaboard Process Fuel Gas Scrubber

This matter was also covered in the report
answering questions submitted by the late
Dr. E. H. Boomcr.

Value of abandoned unit \$9216.16
(Schedule attached)

Total Engineering Hazards \$10649.16

I think that answers all the questions which I made notes
of or that I was requested to get information on.

Q THE CHAIRMAN: When you speak of the original
scrubbing plant being abandoned, that is the one that came from
Coutts?

A Right, the tower came from Coutts.

Q And the plant was operated at a pressure of 65 pounds?

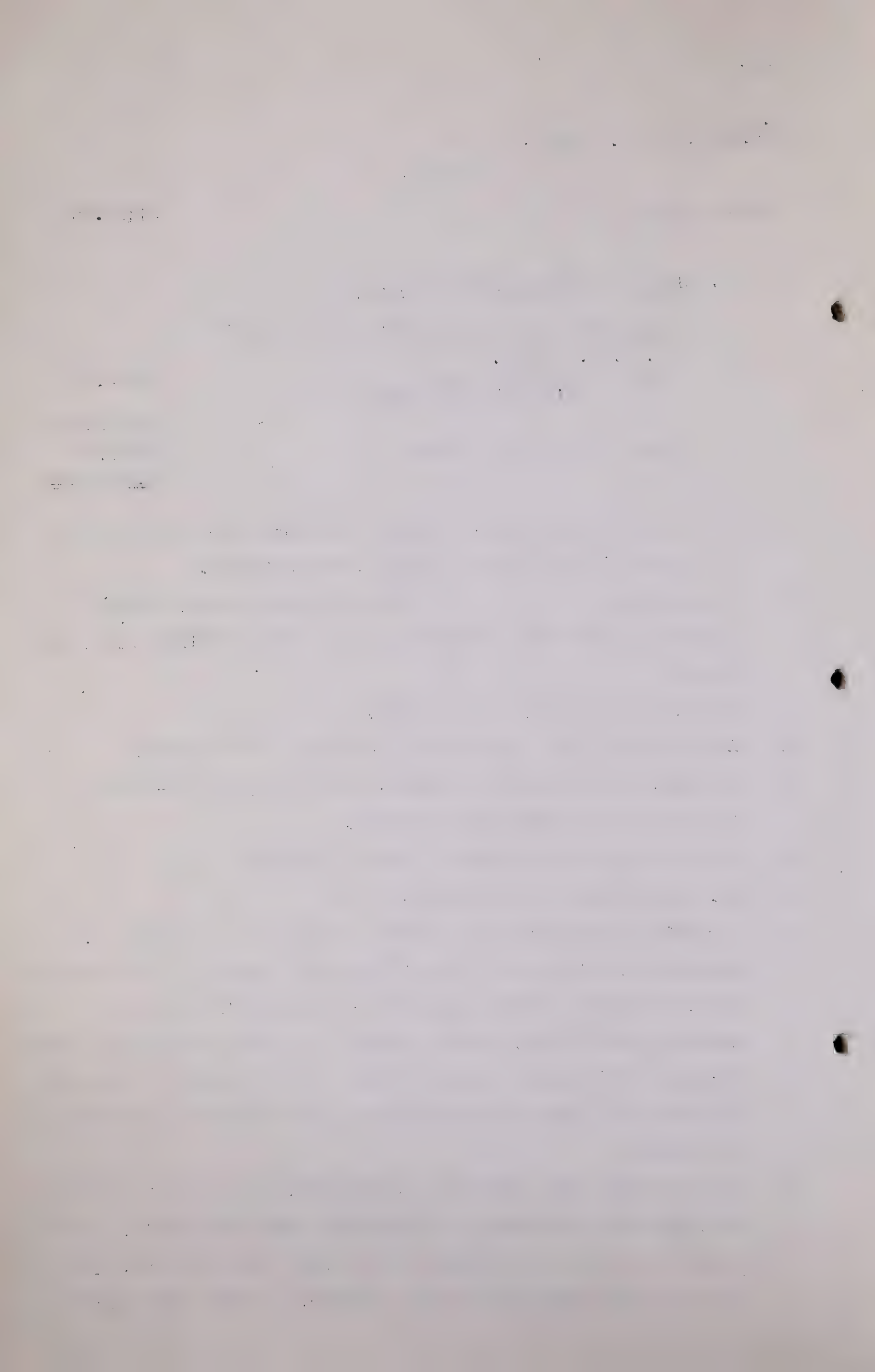
A In 1943. One-third of the plant. There was just one-third of
it put on for experimental purposes.

Q That was 10 pounds below its normal pressure?

A No, the pressure of 150 pounds.

Q I realize I used two words which I should not have used, Mr.
Donnellan, I said in one place "tremendous amount of new equipment"
and in another a "vast amount of new equipment", I think I
used the wrong words, so the answers you have given me are exactly
correct, but I am now going to ask you the amount of equipment
you would be required to purchase if you reduced the pressure of
the plant?

A I anticipated that question, Mr. Chairman, and I am up against
an impossible situation. The engineers have not done it, and all
I can refer to is the fact that we tried this plant out. Now
if we ran the plant at reduced pressures, I could turn around



R. Donellan,
Dir. Exam. by Mr. Harvie.

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and tell you you would not have to spend a cent, but on the other hand you are going to tell me you want to run that plant economically and efficiently, where are you going to draw the line?

Q Well in order to reduce the working pressure of the plant, you would have to spend a lot of money in the purchase of equipment, would you not?

A I would have to go back and make further inquiries.

THE CHAIRMAN: Now is there any cross-examination arising out of the information Mr. Donellan has now given us?

MR. CHAMBERS: I have some questions I would like to ask, but there are some more statements to be prepared.

THE CHAIRMAN: Do you know, Mr. Harvie, when they will be ready?

MR. HARVIE: They will be ready shortly.

THE CHAIRMAN: And will you see that they are distributed to all Council?

MR. HARVIE: Yes.

THE CHAIRMAN: Is there anything more we can go on with this morning, or do you want to wait for those statements before you cross-examine?

MR. CHAMBERS: I do not think it is very much that I can usefully go on with this morning.

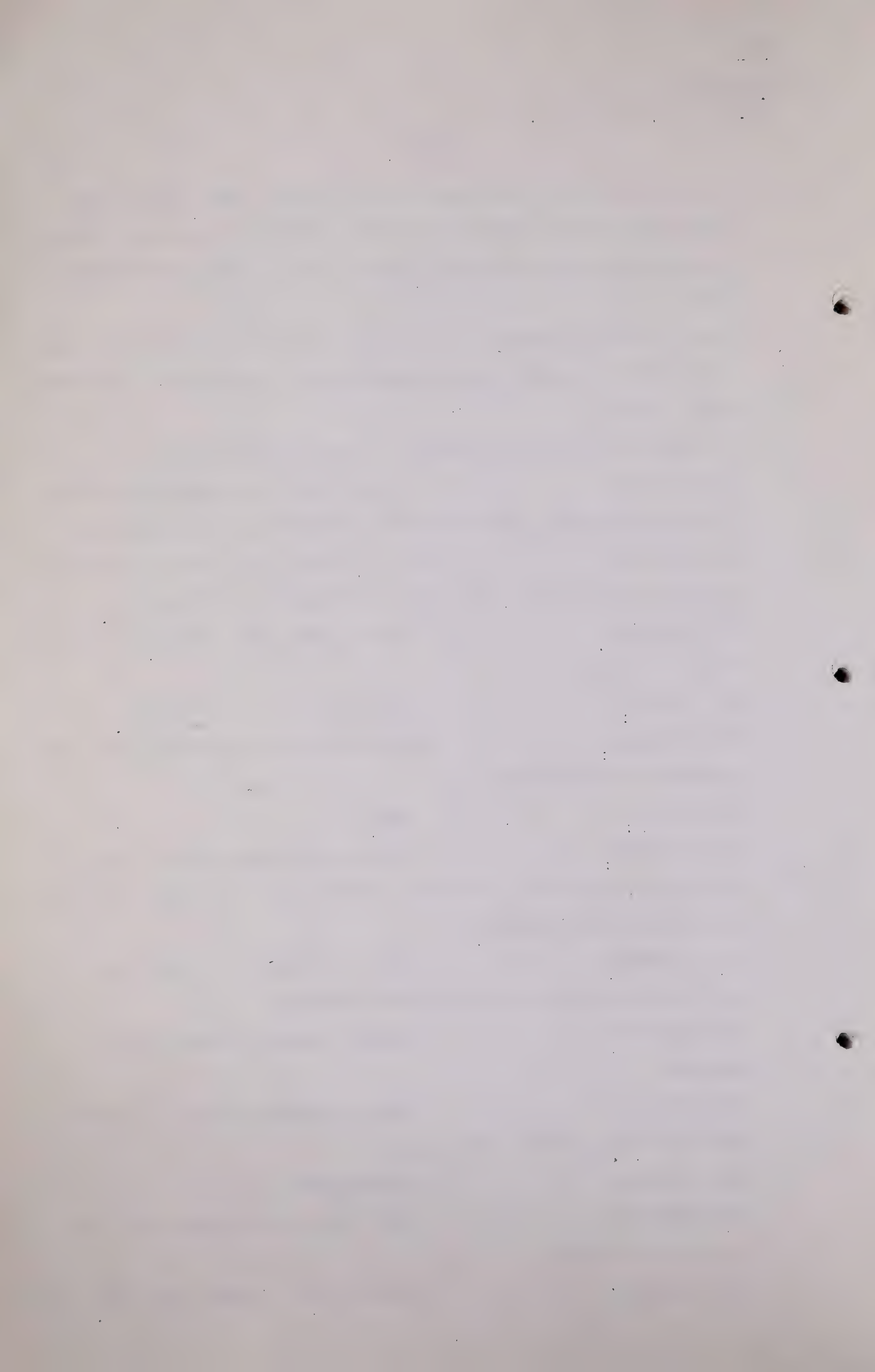
THE CHAIRMAN: I dislike wasting twenty-five minutes.

MR. HARVIE: Well Mr. Hamilton might go ahead with the B.A. Operating Statement.

THE CHAIRMAN: Mr. Blanchard?

MR. BLANCHARD: Well that is all right, Sir, we can start on that.

THE CHAIRMAN: Then you will stand down, Mr.



R.W. Hamilton, recalled,
Dir. Exam. by Mr. Blanchard.

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Donellan and Mr. Hamilton can be recalled.

ROBERT WINSLOW HAMILTON, having
been recalled:

WITNESS: The question of the British
American Operating Costs is discussed in Volume 2, Section 8,
Page 43, the alternative statements being W-H-53 to 56 of
Volume 1.

I have not checked this section
to see whether it conforms with the evidence we have now had,
that is as to our rate base, or whether it will need to be
revised, but I will endeavour to interpolate anything which
may be necessary for a proper understanding of this section 8.

Reading now from page 43 of
Volume 2:

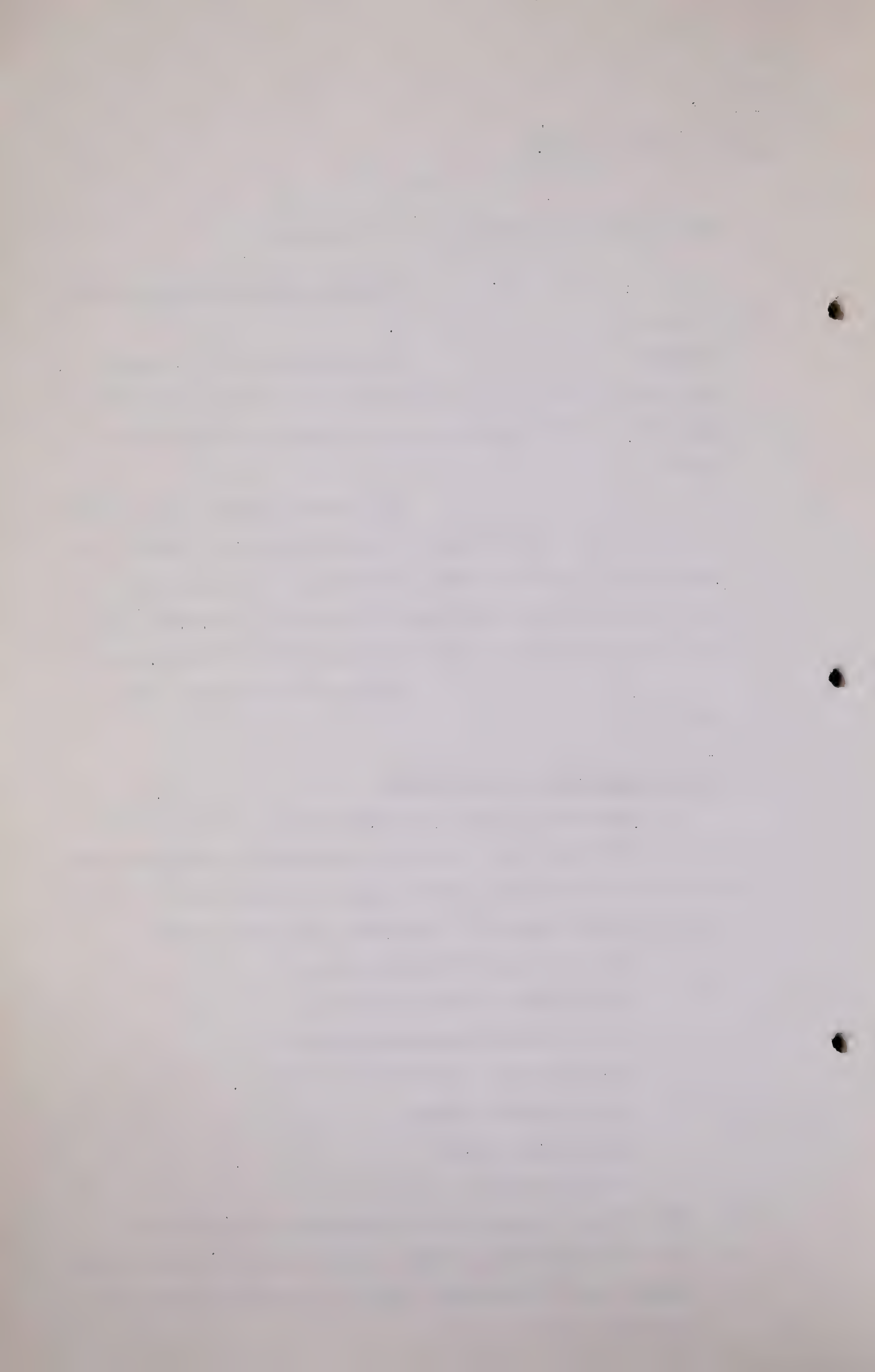
BRITISH AMERICAN COST SUBMISSION

The British American cost submission as contained in
Volume 3, that is their Volume 3, presents the estimated cost
of the utility company for the ten-year period 1945 to 1955.
Costs are shown under the following functional heads:

High Pressure Gathering Lines
Low Pressure Gathering Lines
Low Pressure Compression Station
High Pressure Compression Station
High Pressure Lines
Repressure Lines
Water Station.

No attempt is made in the submission to allocate:

- (a) Water Station costs between British American Oil Company
Limited and Low Pressure and High Pressure Compression
Stations, or



R. W. Hamilton, recalled,
Dir. Exan. by Mr. Blanchard.

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- (b) High Pressure Compression Costs between Residue Transmission and Repressuring functions. or
- (c) Gathering Costs between British American Oil Company Limited Absorption Plant and Residue Gas business. or finally
- (d) Residue Transmission costs between British American and Gas and Oil Products residue gas,

In this regard we understand that pending further developments, the company is unwilling to suggest a basis for the foregoing allocations. In our Statements W-H-53 to 55, however, in presenting costs on the British American basis for comparative purposes, we have made certain tentative allocations from information furnished to us.

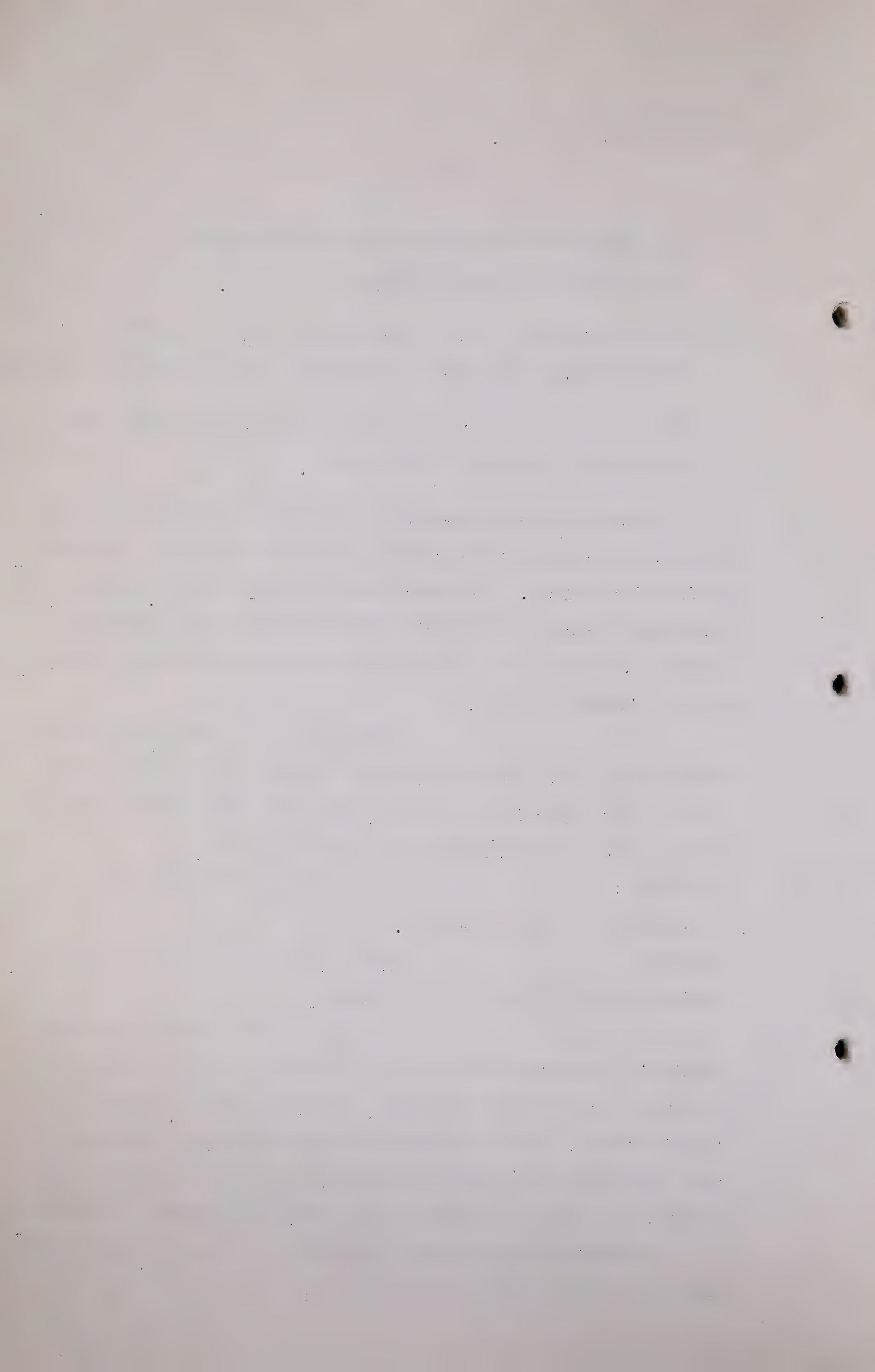
I might say, of course, that subsequent submissions by the British American Company and also the actual results for a portion of the year 1945, do make certain some, if not all, of the allegations we speak of here.

MR. HARVIE: That is Exhibit 113 "B", "C", and "D", just for record purposes.

WITNESS: And we, of course, were not anticipating to deal with this this morning.

Further, the British American submission contains no reference to gas volumes anticipated to be handled and we have therefore, in W-H-42 and 43, assumed certain volumes for the purpose of indicating possible unit costs resulting from the British American and alternative cost concepts as presented in Statements W-H-53 to 55 above mentioned.

The British American cost submission in Volume 3, classifies functional costs under the headings of:



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Operating Cost.

Administration

Amortization of Capital Expenditures

Return on Investment.

The following comments relate thereto.

Operating Costs.

With the exception of the High Pressure Gathering Lines and the Water Station, no part of the facilities have been previously operated and operating costs, therefore, are not available. The amounts provided have consequently been accepted subject to further information. No provision has been made for payment for fuel gas.

Administration

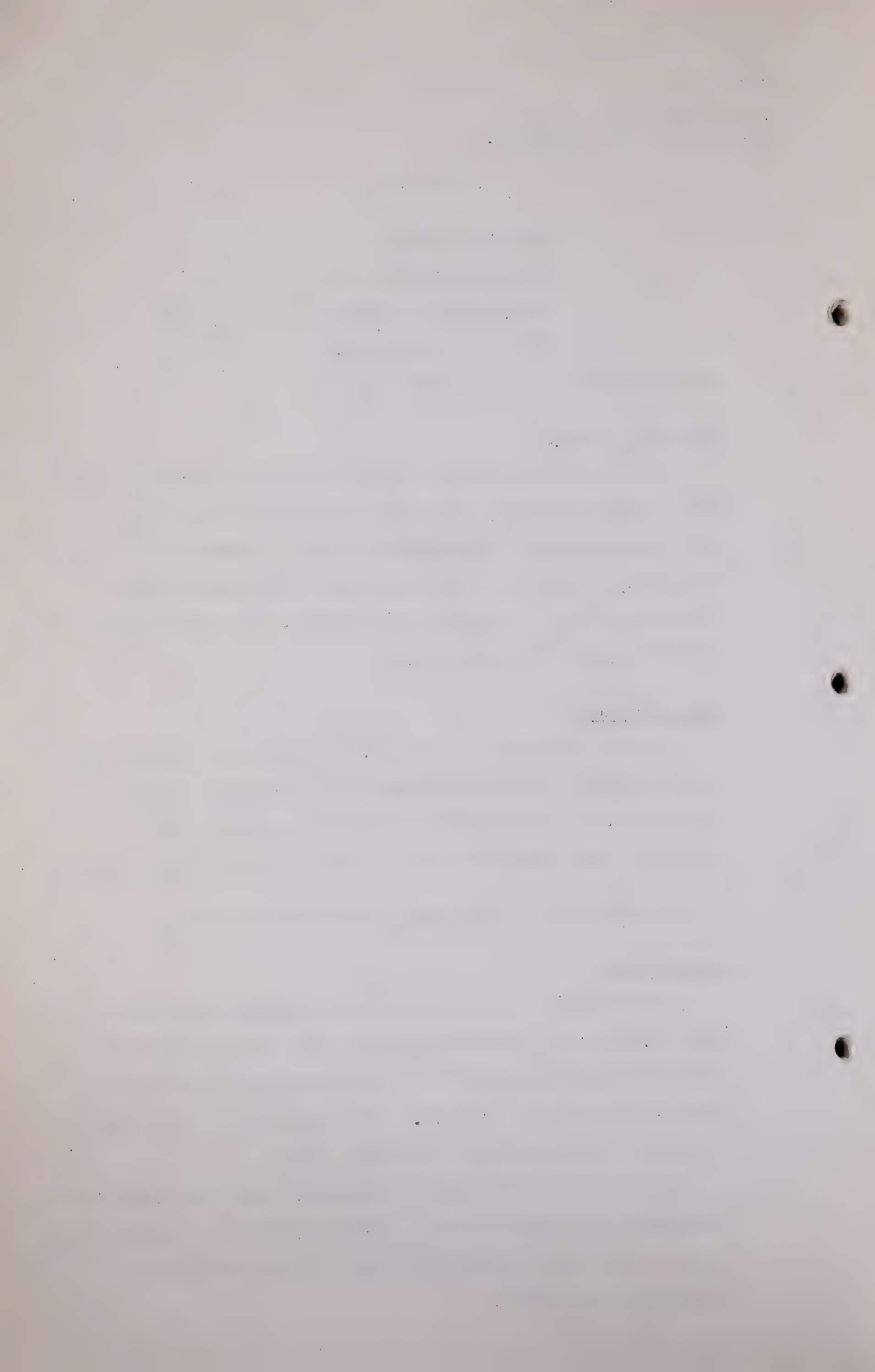
A total provision of \$15,000.00 per annum has been made by the company to cover overhead costs outlined on page 3 of Volume 3. We understand that it is proposed that a flat charge of this amount be made by the parent company each year.

I should like to discuss that at another point.

Amortization

Amortization is based on a total opening rate base of \$893,121.00 which includes the appraisal value of assets formerly comprising part of the operating plant of British American Oil Company Limited. Our comments in this regard are dealt with in Section 1 of this report.

No salvage values are contemplated, and the entire fixed investment is amortized over a ten-year term on a straight line annual basis. Our views with regard to depreciation are presented in Section 6.



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Return on Investment

Return on investment has been computed at the rate of 15-5/6 (net 9 $\frac{1}{2}$ %) in each year on the rate base at the beginning of the year. (It is to be noted in this regard that the Madison rate of return, while at the same rate, is applied to the average rate base for the year), and incidentally on a declining rate base the British American method as applied here would result in a slightly higher dollars and cents return than what the alternative followed by the Madison. Strictly speaking, I think Madison's method is theoretically more correct.

Q MR.HARVIE: You are familiar, Mr.Hamilton, that that again was adjusted in this other exhibit?

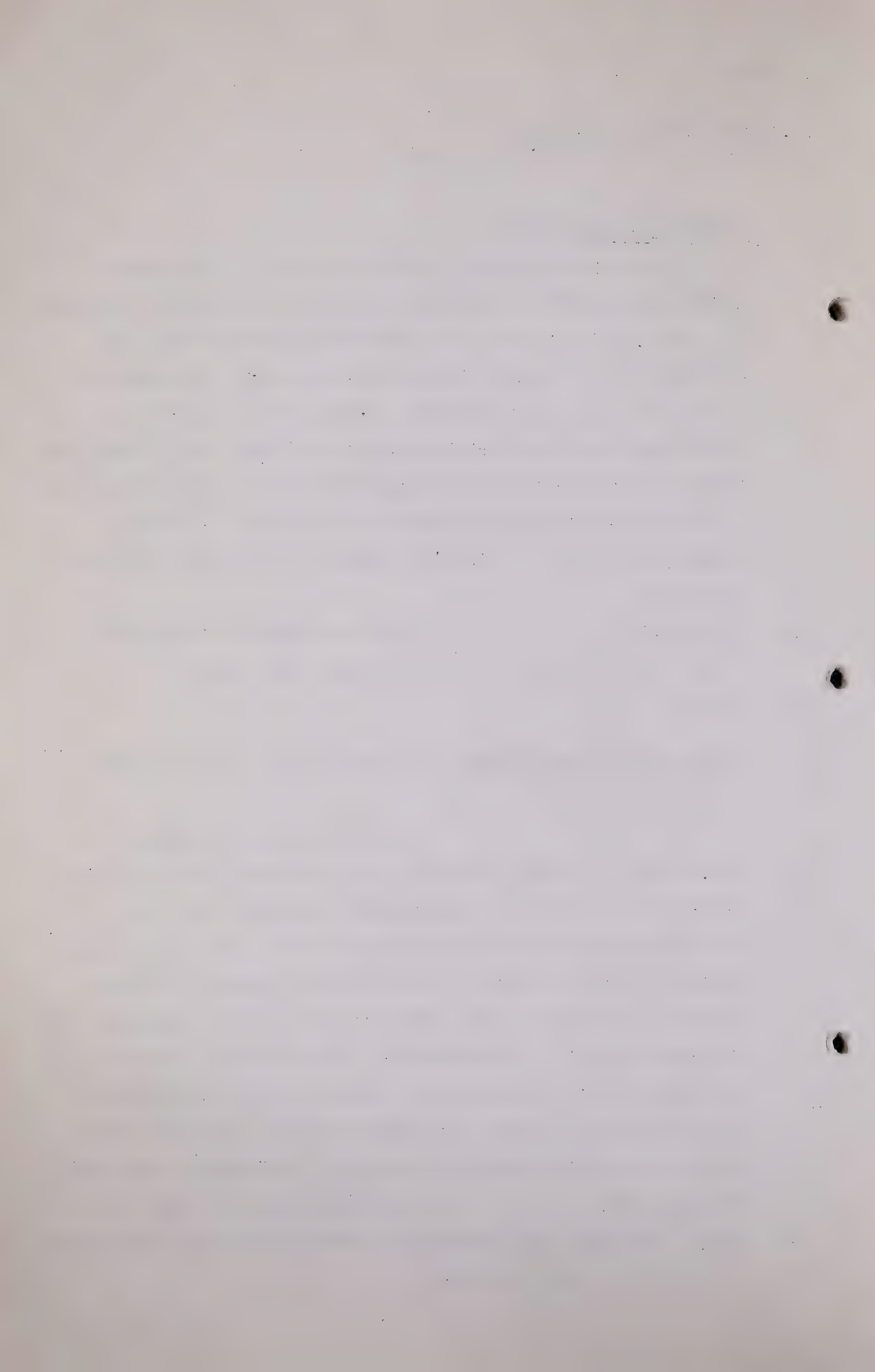
A Right.

ALTERNATIVE OVERALL COSTS - The British American, 4 years, 1945 to 1948.

I should say that inasmuch as the Madison forecast extended up to the end of December 31st, 1948, we deemed it appropriate to consider the cost of the British American Company on the overall basis for the same period, so that the Board would have the information before it as to the trend of the combined costs for both companies for the same period. Unfortunately, with respect to the average of those years, a complication arises in that the Madison's operations would be the five-year operation including 1943, whereas the British American would be a four-years' operation.

MR. CHAMBERS: You said 1943, you mean 1944?

A 1944, pardon me, and consequently certain technical difficulties creep out in those averages.



M-3-1 - 11.44 A.M.

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A First of all on British American basis with certain necessary assumptions as to functional distribution.

ALTERNATIVE OVERALL COSTS - B. A. 4 years 1945 to 1948

Similar to the presentation in connection with Madison costs, we submit Statements WH 53 to 55 to show a comparison of B. A. costs by functions, on the following bases:

B. A. Basis - after allocations made by us of Water Station and Compression costs - using total opening rate base \$893,121. - using Capital Allowance \$20,000 - using Amortization 10 years straight line with no provision for salvage. Using rate of return 15 5/6%.

That was one basis.

^{first}
The/alternative suggested to you is described as:

Alternative Basis B in which the operating expense and Administration is adopted as per the B. A. submission with plant fuel added. The total opening rate base utilized was \$739,100. Working capital allowance adopted at \$15,000.00. Depreciation was provided on a net withdrawal throughput basis with no provision for salvage, rate of return applied:

- 1) at 15 5/6%, which is a net 9 1/2%.
- 2) Then again at 11 2/3%, which is net 7%.

So that alternative treatments results in two answers depending upon which rate of return you apply. Then we adopt an alternative basis C, in which the operating expense and Administration was taken as given by the British American, Plant fuel added. The total opening rate base of \$812,175 was used. Working Capital allowance \$15,000. Depreciation again on a net withdrawal basis, but allowing salvage and

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using the two rates of return, $15 \frac{5}{6}\%$ or $9\frac{1}{2}$ net, and $11 \frac{2}{3}\%$ or 7 net. In all cases we have reduced the cost of residue transmission by \$12,000 per annum in respect to the estimated contribution to be made by Madison for transmitting G.O.R. gas over a portion of the British American line.

The application of the variations suggested in Basis B-1 results in a reduction of the net overall average annual cost of \$52,842 (without changing the rate of return), which may be summarized as follows:

Net Overall Annual Average Cost - per B.A. Basis -	\$272,463	
Add: Provision for Fuel Costs		921
		<u>273,384</u>
Deduct:		
Reduction in Depreciation (net)	\$34,640	
Reduction in Return on Investment	19,123	53,763
		<u>53,763</u>
Net Overall Annual Average Cost -		
Basis B-1		<u><u>\$219,621</u></u>

Perhaps it would be appropriate at this stage now to look at the Cost Statements.

Statement WH 53 is a comparative presentation of the estimated annual and the estimated average cost of gathering gas using the British American basis with some variations and then two alternative bases in the case of each of which two separate rates of return were applied.

Statement WH 54 prepared on the same basis...

MR. HARVIE: May I interrupt to clear one point while on Statement WH 53, on your alternative basis B and C I note that net depreciation on alternative Basis B, you use the

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figure \$26,000.00 and on C \$30,000.00 ?

A Yes sir.

Q Just on what basis is that figure arrived at - on the sixteen year basis ?

A My recollection is that the difference is occasioned by the difference in the opening rate base, very largely. You see in the Basis B you have a lower rate base than you have in Basis C and consequently your amortization would be less. It looks to me that there is a difference in the salvage which I would be glad to look up and advise you on.

Q Was that on the basis of ten years ?

A Neither of them were on a ten year basis. They are both on a net withdrawal basis.

Q On the estimated throughput basis ?

A Yes. That is right. Similar to the presentation contained in WH 53 for gathering costs we have Statement WH 54 dealing with comparative costs compilations for the cost of residue transmission. That is the cost of operating the lines from the British American plant to the Madison scrubber through which passes the British American residue gas and also for a portion of the line going from the Gas & Oil Refineries which has been boosted at the Madison #3 and comes back in the British American main line.

Statement WH 55 prepared on a comparable basis has to do with the various comparative estimates of the cost of repressuring, using the same cost approaches.

Now for a better understanding of the results, we might have a look at WH 53 which has to do with gathering. The first four monetary columns deal with the estimates for the various years and then follows a column setting out the

1945

The first part of the report deals with the general situation in the country. It is a very interesting and informative study of the country's development. The second part of the report deals with the specific details of the country's development. It is a very detailed and thorough study of the country's development. The third part of the report deals with the specific details of the country's development. It is a very detailed and thorough study of the country's development. The fourth part of the report deals with the specific details of the country's development. It is a very detailed and thorough study of the country's development. The fifth part of the report deals with the specific details of the country's development. It is a very detailed and thorough study of the country's development. The sixth part of the report deals with the specific details of the country's development. It is a very detailed and thorough study of the country's development. The seventh part of the report deals with the specific details of the country's development. It is a very detailed and thorough study of the country's development. The eighth part of the report deals with the specific details of the country's development. It is a very detailed and thorough study of the country's development. The ninth part of the report deals with the specific details of the country's development. It is a very detailed and thorough study of the country's development. The tenth part of the report deals with the specific details of the country's development. It is a very detailed and thorough study of the country's development.

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average and then finally that is related to an average cost per rateable Mcf. I would ask you to bear with me on the use of this rateable Mcf. until another point. Under the British American basis the top section you will find that the operating costs are estimated to be \$30,703.00 in each year. In other words no variation was suggested. Likewise with administration. Likewise with depreciation. The only variable factor on the British American basis would be a return on the investment by reason of the diminishing rate base. On the British American basis the average cost, that is the British American basis subject to one or two necessary extensions, we had to make to get an answer of any kind, you have a total operating cost of \$140,000.00 average for gathering which on approximately five billion feet would represent 2.85 cents per Mcf. Now the alternative basis B utilizes the same operating expense and administration expense as the British American basis operating expense of \$30,703.00 in each year and in administration of \$6,923.00 in each year. Plant fuel is added in the alternative basis B-1 in the ^{other} two statements, but no plant fuel is chargeable against gathering. The total opening rate base, that is not only with regard to gathering lines but on the basis of a revised rate base of \$739,100 and a reduced working capital allowance and also changing the scheme of amortization from a ten year straight line right on to an amortization basis of net withdrawal in terms of wet gas you get a substantially lower depreciation charge. In 1945 for example you get \$26,188.00 as compared with the British American amortization of \$43,000.00. And in terms of unit cost the depreciation on this alternative basis B cost .436 cents as compared with .876 cents. It is about half.

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Now, return on investment. By reason of the reduced rate base is likewise less even though at the same rate. So that alternative basis B-1 for example gives you for 1945 a return of \$46,450.00 as compared with \$69,583.00 due, not to any change in the rate, but in regard to a change in the amount of the rate base and a shifting from opening rate base to mid-year rate base. In effect the return on the investment on the alternative basis B-1 works out at .84 cents as compared with .12 cents on the British American basis. Utilizing all other features of Basis B which we have discussed, we merely cut the rate from $15 \frac{5}{6}$ to $11 \frac{2}{3}\%$, all other factors remaining the same, the unit cost for gathering will be 1.82 cents as compared with 2.04 cents at the higher rate and as compared with 2.85 according to the British American estimate.

THE CHAIRMAN: Perhaps you had better not start anything fresh.

A I just want to make one further comment if I may do so at this point. I should say that the significance of \$739,100 rate base suggested in Basis B is that it conforms to the second rate base determination contained in WH 13, namely it is that rate base which utilizes the book value of the old gathering lines and water stations.

(At which time the Hearing was adjourned until 9.30 AM.

December 11th, 1945)

Mr. H. B. ...

